

D.P.U. 91-234-A

Petition of Commonwealth Electric Company and Cambridge Electric Light Company, pursuant to M.G.L. c. 164, §§ 69I, 76, 94, and 220 C.M.R. §§ 10.00 et seq., for review of the procedures by which additional energy resources are planned, solicited, and procured by Commonwealth Electric Company and Cambridge Electric Light Company.

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## I. INTRODUCTION

### A. Background

On April 15, 1992, pursuant to the integrated resource management ("IRM") regulations,<sup>1</sup> Commonwealth Electric Company ("Commonwealth") and Cambridge Electric Light Company ("Cambridge") (together "the Companies"), submitted their Initial Filing to the Department of Public Utilities ("Department") and the Energy Facilities Siting Council ("Siting Council").<sup>2</sup> The Office of the Attorney General ("Attorney General"), Commonwealth of Massachusetts Division of Energy Resources ("DOER"), Conservation Law Foundation ("CLF"), Massachusetts Public Interest Research Group ("MASSPIRG"), Massachusetts Save James Bay, Boston Edison Company, Fitchburg Gas & Electric Company, Western Massachusetts Electric Company ("WMECo"), New England Cogeneration Association, Coalition of Non-Utility Generators, Inc. ("CONUG"), Burriellville Energy Corporation, CES/Way International ("CES/Way"), Massachusetts Institute of Technology ("MIT"), and Massachusetts Restaurant Association sought and were allowed to

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<sup>1</sup> The IRM process consists of four phases. Phase I involves the Companies' submittal of the draft initial filing and initial filing and the Department's review of those filings. The IRM regulations require that the initial filing contain the Companies' demand forecast, resource inventory, evaluation of resource need, evaluation of resource potential, resource solicitation request for proposals ("RFP"), and initial resource portfolio. Phase II is comprised of the Companies' resource solicitation process when the Companies issue a Department-approved RFP. In Phase III, the Department reviews the Companies' resource mix and award group, and, in Phase IV, the Department reviews and approves contracts resulting from the resource solicitation. This is the first filing by the Companies pursuant to the IRM regulations.

<sup>2</sup> The IRM process, as initially implemented, established a coordinated review of electric utility resource planning and acquisition by the Department and Siting Council. On September 1, 1992, the Siting Council was merged into the Department.

intervene as parties in this proceeding. In addition, Eastern Edison Company, Massachusetts Electric Company, Cape and Islands Self Reliance Corporation ("Self Reliance"), International Brotherhood of Boilermakers, Iron Ship Builders, Blacksmiths, Forgers & Helpers (Local 29), and Stephen Cook on behalf of the Greater New Bedford NO-COAL ti ti on sought, and were allowed to participate as interested persons.

With the Initial Filing, the Companies submitted a motion requesting an exception from certain of the ILM regulations pertaining to the requirement to issue requests for proposals ("RFPs") for demand-side management ("DSM") resources ("April 15, 1992 Motion").<sup>3</sup> On May 29, 1992, the Department and the Siting Council granted the Companies' April 15, 1992 Motion to the extent that a DSM RFP would not be required at the time, and established a schedule for the Companies' DSM solicitation.<sup>4</sup>

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<sup>3</sup> On April 18, 1992, the Companies, the Attorney General, CLF, MassPIRG, CES/Map, and Northeast Utilities Service Company (for WMECo) submitted an Offer of Settlement ("Offer") intended to resolve certain issues in their Phase I ILM filing. Specifically, the Offer identified as committed, for purposes of their Phase I review, conservation and load management ("C&LM") programs being developed by a C&LM Task Force pursuant to the Department's Order in Commonwealth Electric Company/Cambri dge Electric Light Company, D.P.U. 91-80 Phase Two-A (1992). The Offer also provided that a DSM RFP would not be issued in this ILM proceeding. On May 15, 1992, in a joint response, the Department and Siting Council rejected the Offer.

<sup>4</sup> On May 29, 1992, the Department issued an Order that established the following schedule for a DSM RFP: (1) on July 1, 1993, the Companies would file a DSM RFP with the Department for review; (2) on November 1, 1993, the DSM RFP approved by the Department would be issued by the Companies; (3) on February 1, 1994, responses to the RFP would be due; (4) on April 1, 1994, the Companies would submit a proposed Award Group to the Department for review and approval; (5) on June 1, 1994, final Award Group contracts would be submitted to the Department for review and approval; and (6) on July 1, 1994, implementation of approved programs would begin.

## B. Procedural History

Pursuant to the schedule established for the DSM solicitation, on July 1, 1993, the Companies submitted the DSM RFP for Department review.<sup>5</sup> The Department conducted a technical session on the Companies' filings,<sup>6</sup> a prehearing conference, and four days of evidentiary hearings. In support of their filings, the Companies sponsored the testimony of Kevin F. Harnett, manager of demand program planning for the Companies; Beauford L. Hunt, Jr., manager of integrated planning for Commonwealth; Peter Fox-Penner, vice president of Charles River Associates ("CRA"); Peter J. Spinney, director of resource planning and demand management at CRA; Anthony J. Casella, manager of rate administration for the Companies; and Alan F. Destribats, senior vice president of Synergi c Resource Corporation. The evidentiary record consists of 13 exhibits submitted by the Companies, 81 exhibits submitted by the Department, eight exhibits submitted by the Attorney General, 20 exhibits submitted by MASSPIRG, 31 responses to Record Requests issued by the Department, and eight responses to Record Requests issued by MASSPIRG. On August 26, 1993, the Hearing Officer established a briefing schedule requesting initial briefs on September 16, 1993 and reply briefs on September 23, 1993.<sup>7</sup>

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<sup>5</sup> With the DSM RFP, the Companies also submitted their Initial Resource Portfolio for demand-side resources.

<sup>6</sup> In addition, the Department conducted two technical sessions prior to the Companies' filings.

<sup>7</sup> On September 10, 1993, the Hearing Officer granted a motion of the Attorney General to extend the briefing schedule until September 20, 1993 for initial briefs, and September 27, 1993 for reply briefs.

## II. SCOPE OF REVIEW

Pursuant to the LRM regulations, the purpose of an RFP is to solicit resource proposals from project developers. See 220 C.M.R. § 10.03(10)(a). An RFP should solicit all the information necessary to compare proposals and determine the mix of resources that is most likely to result in a reliable supply of electrical service at the lowest total cost to society. Id. Further, an RFP should contain all information necessary for project developers to understand and compete fairly in the solicitation process. Id. See also, D.P.U. 89-239 (1990). In addition, the LRM regulations prescribe the contents of an RFP, and the project selection criteria and ranking system. 220 C.M.R. §§ 10.03(10)(c), 10.03(10)(d).

Accordingly, the Department's review of the Companies' proposed RFP will include an evaluation of the resource block (Section III), resource selection criteria (Section IV), ranking system and project selection process (Section V), and Initial Resource Portfolio (Section VI).

### III. RESOURCE BLOCK

#### A. The Companies' Proposal

The Companies proposed to acquire the DSM resources consistent with the highest scoring proposals of those submitted, within a given budget level for each major rate category<sup>8</sup> for Cambridge and Commonwealth (Exh. C-DSM-10, at 4). The rate category-specific budget levels were calculated by first projecting the amount of total revenue to be collected via the conservation charge ("CC") levels established in the Department-approved settlement in D.P.U. 91-80 Phase Two-A (i.d. at 4-5). The Companies then subtracted from the total revenue projections anticipated costs associated with administration,<sup>9</sup> implementation of the Companies' conservation voltage regulation program ("CVR"),<sup>10,11</sup>

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<sup>8</sup> The major rate categories include residential nonheating, residential heating, small commercial and industrial ("C&I"), and medium/large C&I.

<sup>9</sup> The administrative costs that the Companies proposed to subtract from the total revenue projections include the costs of (1) process and/or impact evaluations associated with each program implemented regardless of the bid, (2) contract negotiation, (3) measurement and verification of estimated kilowatt hour savings, and (4) other administrative services (Exh. DPU-DSM-42).

<sup>10</sup> CVR is a conservation program that is applied to an electric company's distribution system. This program consists of measures and operating strategies designed to provide electricity service at the lowest practicable voltage level in a cost-effective manner, while meeting all applicable voltage standards. CVR lowers customers' energy and capacity consumption by lowering the average voltage applied to customers' appliances. Cambridge Electric Light Company/Commonwealth Electric Company, D.P.U. 93-15/16, at 19 (1993).

<sup>11</sup> In Boston Edison Company, D.P.U. 90-335, at 67-68 (1991), the Department determined that CVR is less conducive to implementation by an outside party secured through an RFP than are other forms of DSM. Therefore, the Department directed the Companies to submit a proposed CVR program plan and budget. Cambridge Electric Light Company/Commonwealth Electric Company, D.P.U. 92-218, at 18. In D.P.U. 93-15/16, the Department approved the Companies' proposed CVR budget

lost base revenues due to programs implemented via the DSM RFP, and existing DSM commitments,<sup>12</sup> to determine the annual budget levels available for program implementation within each major rate category (i.e., available to bidders for DSM services) (i.d. at 4-5, DPU-DSM-38; RR-DPU-DSM-6).

In D.P.U. 91-80 Phase Two-A, the Department approved the CC levels proposed by the Companies and the active parties<sup>13</sup> of \$0.0025 per kilowatthour ("KWH") for the residential non-heating rate category and \$0.0045 per KWH for the residential heating, small commercial and industrial ("C&I"), and medium and large C&I rate categories (See Exh. C-DSM-10, at 4-5). The Companies noted that although the CC levels agreed to in D.P.U. 91-80 Phase Two-A were legally binding only for Commonwealth during 1992, "the Companies view such levels as a sound starting point in developing reasonable budgets for incremental [conservation and load management ("C&LM")<sup>14</sup>] resource acquisition at this time" (i.d. at 4, n.5). The Companies also proposed to increase the CC levels each year by

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levels of \$76,000 and \$18,000 for Commonwealth and Cambridge, respectively, for the period July 1, 1993 through June 30, 1994. D.P.U. 93-15/16, at 25. The Department directed the Companies to submit C&LM budgets for 1994 and 1995 as part of the Companies' next CC filing. *Id.* at 25-26.

<sup>12</sup> Existing DSM commitments include internal amortization (i.e., financing by the Companies) of past DSM expenditures, external amortization (i.e., financing by a DSM service provider) of past DSM expenditures, approved but not-yet-implemented projects from the Customized Rebate Program, and lost base revenues associated with past DSM program implementation for all programs (Exh. DPU-DSM-38).

<sup>13</sup> In addition to the Companies, the active parties to D.P.U. 91-80 Phase Two-A included the Attorney General, DOER, Save Our Region's Economy, I RATE, Inc., Energy Engineers Task Force, and State Senators William O. MacLean, Jr. and Henri S. Rauschenbach.

<sup>14</sup> The terms DSM and C&LM are used interchangeably within this Order.

three percent to reflect inflation (i.d. at 5). As proposed, the Companies' CC Levels and associated budget Levels are presented in Table 1.

The Companies had originally proposed that the RFP state that "proposers should be aware of the fact that the [Department] or the Companies may suspend, defer, or cancel this procurement, or that no offers may be accepted, nor contracts signed, as a result of this solicitation" (Exh. C-DSM-7, at 2). The Companies altered that statement to read "proposers should be aware of the fact that the [Department] or the Companies may suspend, defer or cancel this procurement as a result of an Order from the Department (Tr. 1, at 14). The Companies indicated that the change in the RFP was necessary to assure potential bidders that the RFP is intended to result in the procurement of DSM programs and will not be arbitrarily cancelled (i.d.).

## B. Positions of the Parties

### 1. The Attorney General

The Attorney General argues that the Companies' resource block proposal (i.e., rate-category specific budget allocations based on the CC Levels developed in D.P.U. 91-80 Phase Two-A) is appropriate because it relies on consensus agreements that were forged among a diverse array of the Companies' customers and other intervening parties (Attorney General Brief at 3). The Attorney General contends that "the Companies' proposed conservation charges appear to be a carefully crafted and pragmatic resolution of complex and competing interests in least-cost resource acquisition and rate continuity" (i.d.). In addition, the Attorney General asserts that the Companies should acquire the maximum amount of cost-effective DSM resources within the rate levels that ratepayers can tolerate (i.d.). The

Attorney General contends that if the Companies were to spend less than the maximum ratepayers can tolerate, as would happen if an energy block were put out to bid or if the DSM budgets were decreased, least-cost resources that could be procured would not be procured, cream-skimming would be encouraged, and cost-effectiveness would be diluted by spreading fixed costs over fewer savings (i.d. at 4).

The Attorney General also asserts that the Companies should be directed to amortize more of their DSM program expenditures so that the amount of DSM implementation that can be achieved in the near term can be expanded (i.d. at 5). The Attorney General argues that "[o]ther Massachusetts utilities, faced with a similar desirability of increasing short-term DSM programming, have adopted substantial levels of amortization (i.d., citing Boston Edison Company, D.P.U. 91-233 (1992)).

## 2. MASSPIRG

MASSPIRG contends that the Companies' proposed DSM budget levels fail to comply with the ILM regulations regarding DSM resource acquisition, "including specific regulatory standards to minimize total societal costs, acquire all cost-effective DSM, and avoid lost opportunities to the maximum extent possible" (MASSPIRG Brief at 1). MASSPIRG contends that the overall purpose of the RFP is "to determine the mix of resources that is most likely to result in... the lowest total cost to society" (i.d. at 3, citing 220 C.M.R. §10.03(10)(a)). MASSPIRG also argues that the ILM regulations require an electric company to propose an initial resource portfolio (i.e., a company's programs) which "shall be designed to provide reliable electric service to the company's ratepayers at the lowest total cost to society" (i.d., citing 220 C.M.R. §10.03(5)(a)2).



MASSPIRG argues that the Companies' proposed DSM budget levels are unsupported by any quantitative analysis (i.d. at 1). However, MASSPIRG states that the Companies' proposed 1994 budget level should be accepted by the Department in order to provide the Companies with a basis both for their own DSM program proposals, and with an initial DSM RFP target (i.d. at 1-2).

MASSPIRG contends that final DSM budget levels should not be determined until (1) the Companies have received RFP bids, and can determine an optimal mix of resources to provide a reliable supply of electrical service at the lowest total cost to society, as required under 220 C.M.R. §10.05; (2) the Companies have completed their technical potential studies and can determine the extent to which the bids received, including their own program proposals, are adequate to comply with requirements to avoid lost opportunities under 220 C.M.R. §10.03(5)(1)5; (3) the Companies have analyzed optimal DSM budget levels under various contingencies; and (4) several important forecast and planning uncertainties are resolved such as the Department's determination of need in Phase I of this proceeding, and whether the Eastern Energy Corporation facility receives siting approval from the Energy Facilities Siting Board, and/or whether its contract with the Companies is terminated<sup>15</sup> (i.d. at 2).

MASSPIRG argues that within the IRM regulations, there is no consideration given to minimizing short-term rate impacts, if it would interfere with the objective of minimizing long-term social costs (i.d. at 6). MASSPIRG contends that the Companies' concern over

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<sup>15</sup> MASSPIRG contends that termination of the Eastern Energy Corporation facility would warrant further increases in both DSM budgets and avoided costs (i.d. at 10).

rate impacts on non-participants has been addressed in the past when the Department rejected the non-participant rate impact test (i.d., citing Tr. 3, at 6; D.P.U. 86-36-F at 19, 23). MASSPIRG also argues that the Department has articulated its policy that electric companies should take steps to capture all cost-effective DSM and to ensure that DSM program opportunities are available to all ratepayers (i.d. at 7, citing Cambridge Electric Light Company, D.P.U. 87-221-A (1988); Western Massachusetts Electric Company, D.P.U. 87-260 (1988); Western Massachusetts Electric Company, D.P.U. 86-280 (1987); and Boston Edison Company, D.P.U. 85-266-A/85-271-A (1986)). MASSPIRG further argues that the Department has previously found that, where a cost-effective supply or demand option would significantly affect rates in the early years of implementation, the electric company should not abandon the option, but rather propose cost allocation methods or rate structures that reduce the rate impacts to a more acceptable level and more closely match the timing of the costs and benefits over the life of the investment (i.d., citing D.P.U. 86-280 (1987)).

MASSPIRG contends that the Companies distorted the results of an analysis conducted by the Massachusetts Institute of Technology ("MIT Analysis") which indicates that (1) the delay of DSM implementation growth results in higher bills in the long-term, higher total costs, and higher cumulative emissions; (2) doubling or tripling DSM expenditures or tripling just C&I program expenditures reduces system emissions in all cases; and (3) amortization is preferable to delaying DSM expenditure ramp-up under both total societal- or total bills-cost-effectiveness standards (i.d. at 8-9).

MASSPIRG maintains that the Companies inappropriately ignore a report

commi ssi oned by the New Engl and Power Pool ("NEPOOL Report") (i d. at 9). MASSPI RG contends that the NEPOOL Report i ndi cates that "overwhelmi ng agreement (93 percent to 6 percent) among Massachusetts resi dents that they would l i ke thei r electri c company to spend money on programs that help both busi ness and resi denti al customers conserve electri ci ty and use i t wi sely" (i d., ci ti ng Exh. MP-DSM-1). MASSPI RG states that the NEPOOL Report al so i ndi cates that ratepayers show great agreement (71 percent to 28 percent) wi th bei ng "personally wi l l i ng to pay more for ... electri ci ty now i n order to fund conservati on measures that wi l l reduce the need for new power plants i n the future" (i d.).

### 3. Cape and Islands Self-Reli ance Corporati on

Self-Reli ance argues that the Department should i ncrease the Compani es' annual DSM expendi ture l evel s over the 1992 l evel s or l eave the DSM budgets undefi ned unti l more i nformati on i s gathered that would justi fy hi gher l evel s of fundi ng (Self-Reli ance Bri ef at 1). Self-Reli ance contends that DSM i n New Engl and has a "proven track record" of produci ng energy and capaci ty savi ngs at the lowest possi ble cost (i d. at 2). Self-Reli ance al so argues that DSM empl oys l ocal "trades peopl e" and l eaves l ocal resi dents wi th more di sposabl e i ncome, whi ch would have a posi ti ve effect on the Cape's "down" economy (i d.).

Self-Reli ance argues that ratepayers have no escape, other than through DSM programs, from the Compani es' hi gh rates, whi ch are caused by the Compani es' over- contracti ng for power suppl y projects (i d.). Self-Reli ance therefore argues that Commonweal th's ratepayers would suffer a greater negati ve i mpact should the Department choose to reduce the Compani es' DSM budget l evel s (i d.).

#### 4. The Companies

The Companies argue that the proposed budget limitations are reasonable and are consistent with Department precedent in that they establish an appropriate balance between the need to acquire cost-effective resources and the need to avoid undue bill impacts (Companies Brief at 40, citing Commonwealth Gas Company, D.P.U. 91-60 Phase II at 38 (1992)). The Companies contend that the proposed budget levels "will facilitate customer acceptance of DSM, which is critical to the long-term strength of the DSM market" (i.d. at 43-44). The Companies also argue that the rate continuity afforded by the proposed budget levels will enhance the ability of customers to plan for their energy requirements, "an important benefit to larger industrial, commercial and municipal customers in these difficult times" (i.d. at 44).

The Companies argue that there is a continuing consensus on the CC levels that were developed and approved by the Department for Commonwealth in the context of D.P.U. 91-80 Phase Two-A (i.d. at 43). Specifically, the Companies argue that SORE, I RATE, and State Senator Henri Rauschenbach expressed support for DSM budget limitations and "managed expenditures in the present environment" (i.d.).

The Companies contend that MASSPIRG's arguments ignore the flexibility within the I RM regulations which direct that a company's resource plan should be the "most likely" to achieve the lowest total cost to society (Companies Reply Brief at 12, citing 220 C.M.R. § 10.03(10)). The Companies argue that the referenced provision within the I RM regulations mandates that the Companies and the Department consider factors that could interfere with this objective, including the effects of an adverse reaction to DSM

implementation caused by "incremental rate concerns" (i.d.). Therefore, the Companies argue, the ILM regulations "suggest that other factors such as the state of the region's economy and the long-term effects of frustrating or delaying the economic recovery should also be considered to the extent they affect the likelihood of achieving least cost resources" (i.d.).

The Companies contend that MASSPIRG mischaracterizes the record evidence that supports the proposed budget levels (i.d. at 13). Specifically, the Companies argue that MASSPIRG (1) erroneously states that the Companies' budget level proposal was based on the MIT Analysis, and (2) ignores the fact that the MIT Analysis prepared separate reports for the Companies and for the New England region as a whole (i.d.). The Companies also assert that MASSPIRG falsely accuses the Companies of applying the "no losers" cost-effectiveness test when they developed the proposed budget levels, which would be contrary to the Department's mandate to use a societal cost-effectiveness test (i.d. at 15). The Companies contend that the "no losers" cost-effectiveness test was not employed in developing the proposed budget levels, and that they plan to use the "societal" cost-effectiveness test in full compliance with the Department's precedent (i.d. at 15, 16).

The Companies state that they are willing to consider different approaches to the amortization of DSM expenditures, should it be determined by the Department that a different approach would be in the best interests of the Companies' customers and should the Companies have the ability to increase their debt/equity ratios (i.d. at 41, n. 29). The Companies argue that increased amortization may have two negative impacts: (1) amortization increases the total cost of DSM measures by adding finance charges to

program expenses supported by ratepayers; and (2) amortization may limit future DSM budgets or cause unnecessarily high future bill impacts by adding finance charges to future program expenses supported by ratepayers (i.d.). In addition, the Companies contend that bidders may submit bids that incorporate amortization payment schedules consistent with the RFP guidelines, and that the Companies would seek to avoid a situation where "they, in essence, amortize an amount that already includes the winning bidders' financing charges" (i.d.).

### C. Standard of Review

Pursuant to the ILM regulations, an electric company is required to solicit resources to meet any additional resource need identified for each year of the ten calendar years following the Company's initial filing date. 220 C.M.R. § 10.03(8)(b)(2). The ILM regulations state that if no additional capacity need is identified for the planning period, then the RFP shall be for energy or energy savings only. I.d. The ILM regulations also state that the RFP shall specify the amount of additional resources being solicited by the company in both megawatt ("MW") and megawatt-hour ("MMH") (or MW and MMH saved) per year and season based on the size and timing of the resource need identified." 220 C.M.R. § 10.03(10)(c)2.

In D.P.U. 86-36-F, the Department stated that "electric companies should pursue -- through purchase, expenditure, or investment -- C&LM and generation options to the extent that such actions are cost-effective for each company's ratepayers." I.d. at 7. The Department further specified that C&LM programs should be designed to capture all potential lost opportunities, avoid cream-skimming, and distribute the direct benefits (i.e.,

reduced energy and/or load requirements) as broadly as possible among customer classes and subgroups within each class. Id. at 25, 26.

In D.P.U. 91-60 Phase II, the Department stated that we are

"sensitive to some of the negative impacts arising from intense implementation of C&LM, and we recognize that it may not always be feasible for a ... company to procure the optimal amount of C&LM within a short time period. The Department concludes that aggressive C&LM programs can create significant inequities between program participants and non-participants, and can cause negative customer reactions to utility-sponsored C&LM programs. Although the Department remains committed to C&LM, we find that it is appropriate for a company to balance the competing goals of establishing aggressive program penetration targets (i.e., optimizing the resource portfolio), and controlling ratepayer bill impacts." Id. at 38.

In D.P.U. 91-80 Phase Two-A, the Department stated that we remain "committed to conservation as an energy resource with extraordinary value." Id. at 22. The Department went on to state that "[w]hen developing its C&LM programs, a company must take into account ... considerations such as changes in demand for electricity; the financial, technical, and personnel resources of the company; and rate impacts." Id. In that proceeding, the Department found that a proposed settlement agreement reasonably balanced these concerns through expenditure caps, expenditure amortization, and pre-determined levels of DSM implementation. Id. at 16-17.

#### D. Analysis and Findings

The purpose of this section is to determine whether the Companies' proposed resource block fulfills the requirements outlined by the Department's IRM regulations and is consistent with Department precedent on DSM procurement and rate impacts.

First, as stated above, the IRM regulations prescribe that the resource block to be

filled should be specified in MW and MWH (or MW and MWH saved) in the RFP. See 220 C.M.R. § 10.03(10)(c)2. For the purposes of this proceeding, the Department finds that the Companies' proposal to solicit a level of DSM services based on pre-set budget amounts represents a reasonable proxy for a specific MWH resource block.<sup>16</sup> The Department further finds that should we accept the recommendations of MASSPIRG, i.e., to leave the resource block undefined until after the proposals are received, bidders would be left with little information upon which to size and price their program proposals.

Second, Department precedent clearly incorporates the consideration of rate continuity within the context of pursuing other important goals of the Department such as marginal cost-based rates and aggressive implementation of cost-effective DSM. See, e.g., Commonwealth Electric Company, D.P.U. 88-135/151, at 203 (1989) and D.P.U. 91-60 Phase II at 38. In addition, the Department notes that when it is determined that no additional capacity resources are needed (and particularly during periods of low economic growth) greater emphasis on rate continuity may be warranted. In this proceeding, the Department finds that it would be appropriate for the Companies to balance short-term rate impacts with long-term societal costs in developing the RFP resource block.

Third, regarding the arguments made by MASSPIRG that the Companies did not conduct quantitative analyses to determine appropriate budget levels for demand-side resources, the Department notes that such quantitative analyses would require assumptions to

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<sup>16</sup> The Department notes that in future energy- or energy savings-only solicitations, electric companies will be required to solicit a specific MWH resource block consistent with the I RM regulations.



be made regarding the optimal level of DSM procurement. Specifically, the Companies would have to determine their customers' best interest regarding the tradeoff between short-term rate impacts and long-term societal benefit. The Department notes that the record supports the Companies' contention that the proposed CC levels were settled upon by multiple parties representing a diversity of interests before being approved by the Department in D.P.U. 91-80 Phase Two-A. The record also indicates that many of the parties to D.P.U. 91-80 Phase Two-A remain committed to the agreed-upon CC levels. Therefore, the Department finds that the Companies have developed the RFP budget levels based on CC levels that appropriately address the needs of the Companies' customers, and that further quantitative analysis would not greatly benefit the RFP process in this case. Accordingly, the Department approves the proposed CC levels and budget levels for purposes of the instant proceeding.

The Department notes that the objective of this, or any, DSM solicitation should not be solely to achieve a certain level of DSM expenditures, but rather to ensure that the DSM resources that are procured will benefit ratepayers in a manner consistent with reliability and least-cost planning objectives. Moreover, in D.P.U. 90-335, at 138 (1992), the Department stated that "regardless of the payment mechanism an electric company and a third party and/or participant agree to, the host utility ultimately is responsible for the effectiveness of C&LM implementation." The record in this proceeding convinces us that the Companies should use their discretion within the scoring criteria guidelines to procure DSM resources to the full amount of the budget in each rate category only if the proposed programs, as determined through the Companies' ranking, optimization, and negotiation procedures, are

likely to provide exceptional value for their customers. In addition, the Department notes that the DSM regulations require the Companies to document the initial ranking of projects and to support the reasonableness of their decision in any reordering of projects, and in developing their final award group. See 220 C.M.R. §§ 10.05(2)(f), 10.05(2)(g).

Finally, the Department finds that the Companies maintain the right not to accept any of the DSM proposals received. Therefore, the Department directs the Companies to make bidders aware of the possibility that "no offers may be accepted, nor contracts signed, as a result of this solicitation" as the proposed RFP originally stated.

Regarding the Attorney General's recommendation to use greater levels of amortization as a means of increasing the available resource block, the Department, in the past, has found amortization to be a useful tool for increasing DSM procurement in the near-term. See D.P.U. 86-280, at 269 (1987). However, the Department finds the Companies' concerns regarding limitations on future DSM procurement and/or higher future rate impacts to be reasonable. Therefore, the Department will not require the Companies to increase the levels of amortization beyond those proposed in the RFP.

#### IV. RESOURCE SELECTION CRITERIA

##### A. Introduction

The Department's IRM regulations require that the Companies adopt, and explain in the RFP, a ranking system that incorporates all of the selection criteria that will be used to determine the rank order of project proposals received in response to the RFP. 220 C.M.R. §§ 10.03(10)(c) and (d). The ranking system must apply relative weights to the major categories of criteria in order to identify the relative importance of these categories in selecting resources and may be, but need not be, self-scoring. Id. The regulations set out several major categories of criteria that, at a minimum, shall be included in the RFP ranking system (e.g., price, quality and timing of output or savings, project feasibility). Id.

The Companies have proposed a ranking system for the RFPs that includes six major categories of project selection criteria, or program attributes<sup>17</sup> (Exh. C-DSM-7, at 13). The attributes, their assigned relative weights, and the scoring approach with which each are summarized in Table 2. The remaining subsections of Section IV of the Order review the content, description, thresholds, and scoring procedures for each of the Companies' program attributes. The overall role of the attributes in the Companies' resource selection process, and the appropriateness of the assigned relative weights, is considered in Section V, infra.

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<sup>17</sup> In the RFP, the Companies use the terms "program attribute", or "attribute", to indicate a major category of the RFP project selection criteria. We use the same terminology in this Order.

B. Cost-effectiveness

1. The Companies' Proposal

a. Societal Cost-Effectiveness Test

The Companies proposed that, as a threshold, i.e., in order to be included in the initial ranking, a program must pass the Massachusetts societal cost-effectiveness test, which compares the present value of lifetime savings benefits from a program to the present value of all costs to implement that program (Exh. C-DSM-7, at 18-19). The test is described as a ratio of total benefits to total costs, and the aggregation of all measures in a proposal must have a benefit/cost ("B/C") ratio of greater than 1.0 to be considered (i.d.). Benefits include purchased power or generation costs avoided by the Companies, including the value of environmental externalities avoided, as well as any quantifiable and significant end-user benefits other than electricity bill reductions, such as reduced maintenance costs (i.d. at 7). The total present value of the costs in the B/C equation include (1) the full incremental costs of the DSM measures regardless of who pays those costs; and (2) all administrative costs, including verification and evaluation costs, incurred by the Companies that can be attributed to a given program (i.d.).

The Companies proposed that within each market segment, proposals would be ranked relative to the bid with the highest B/C ratio (i.d. at 19). That is, the bid with the highest B/C ratio would receive the full 35 points for this attribute, and the remaining bids in each segment would be awarded points in proportion to this score, with the scale beginning at zero

for a B/C ratio of 1.0 (Exh. C-DSM-5, at 11).<sup>18</sup> According to the Companies, this approach is designed to foster price competition among programs within a customer segment (e.g., residential retrofit or C&I new construction) and to discourage proposals that focus primarily on the least expensive or most profitable DSM measures (Exh. C-DSM-7, at 19).

b. Avoided Costs

The total present value benefits of a proposed project are determined by multiplying the time-differentiated estimated lifetime savings by the electric system's avoided costs. These costs include (1) avoided fuel and variable operations and maintenance costs; (2) avoided environmental externalities costs; (3) avoided or deferred generation capacity costs; (4) avoided or deferred transmission capacity costs; (5) avoided or deferred distribution capacity costs; and (6) avoided line losses and reserve requirements (i.d. at 43).<sup>19</sup> The Companies proposed to provide all bidders with the Companies' most recent five-year, ten-year, and 20-year levelized avoided cost calculations<sup>20</sup> at the time of the

<sup>18</sup> In mathematical terms, the formula for translating B/C ratio into points awarded for proposal X in market segment Z is as follows:

$$\text{Cost-Effectiveness points for X} = \frac{(X's \text{ B/C ratio}) - 1}{(\text{Highest B/C ratio segment Z} - 1)} * 35$$

<sup>19</sup> Although this RFP does not solicit capacity resources, should a bidder propose measures that could contribute capacity savings in future years, those projected savings would be taken into account when computing the B/C ratios using the following data and assumptions: (1) proposer-specified on-peak KWH savings; (2) load research data compiled by the Companies; and (3) industry data on end-use and measure-specific load shapes (Exh. C-DSM-7, at 45).

<sup>20</sup> The Companies originally proposed to provide real levelized avoided costs and nominal levelized avoided costs.

issuance of the RFP, to ensure that bidders could determine the cost-effectiveness of their programs, and to prevent the Companies from having an unfair advantage in this respect (Exh. C-DSM-2, at 12). The Companies testified that the RFP is designed to yield a high level of competition in order to mitigate fears that bidders will bid only slightly below the avoided cost threshold (i.d.). At the same time, by not providing more detailed annual avoided cost data, the Companies ensure that bids in any future supply-side RFP will remain as competitive as possible (i.d. at 13). In addition, the Companies indicated that they expect future all-resources solicitations not to include any avoided cost information, since resources will be compared solely to each other and to electric company bids, not to company-specific avoided costs (i.d.).

The Companies indicated that if avoided cost information were not provided, it would likely cause a market barrier for bidders who could not be certain that their proposals were cost-effective; thus, bidders might not go to the expense and effort to submit bids (Exh. DPU-DSM-58). The Companies stated that in this RFP, bidders would be competing against the Companies and each other, so the avoided cost information would act as a threshold, rather than a ceiling, thereby providing bidders with an incentive to submit proposals with the lowest possible bid price (i.d.). The Companies stated their belief that they would receive proposals that better reflect the Companies' and their customers' needs by providing limited avoided cost information to bidders (i.d.). In addition, the Companies indicated that bidders can already roughly estimate the Companies' avoided costs on the basis of public documents, so the Companies are not substantially harming their competitive position by divulging this limited information (i.d.).

The Companies also indicated their belief that failure to publish some avoided cost information could promote cream-skimming in that bidders might choose to limit their efforts in terms of comprehensiveness in order to be certain of meeting the cost-effectiveness threshold (Tr. 2, at 10). In addition, the Companies stated that because detailed avoided cost information is available only to the Companies, providing some avoided cost information to all bidders would decrease the likelihood of claims of self-dealing (Exh. C-DSM-2, at 12).

In response to a Department record request, the Companies provided information on the Central Maine Power Company ("CMP") all-resource solicitations in 1987 and 1989 (RR-DPU-DSM-32). CMP's avoided costs were included in the first RFP and were not included in the second, although they were on file with the Maine Public Utilities Commission and were readily available to bidders (i.d.). The Companies stated that although bid prices dropped somewhat in the second round, this effect was more likely attributable to the fact that CMP's avoided costs dropped between 1987 and 1989 than to the fact that avoided costs were provided in the first round and not in the second (i.d.). In addition, the response to the record request included an excerpt from the process evaluation of the CMP RFP stating that those bidders who could not determine the avoided costs would not have access to information that ultimately could affect the ranking of their bids (i.d.). The response also indicated that the CMP experience suggests that bidder pricing tends to follow trends in avoided costs, whether they are made available or not, which may be evidence of "gaming" (i.d.). The Companies stated that they weighed all of these considerations in deciding to provide limited avoided cost information to bidders (i.d.).

On brief, the Companies assert that, based on their review of the CMP experience,

they have re-evaluated their original position on disclosing avoided costs (Companies Brief at 17). The Companies maintain that they have found no compelling evidence to support either disclosure or non-disclosure; therefore, they propose to provide only a single ten-year levelized avoided cost calculation, rather than a series of time-specific avoided cost streams (*i d.*).

The Companies proposed to provide up-dated avoided cost information upon issuance of the RFP on November 1, 1993, and to hold this level of avoided costs constant for the purpose of project evaluation through the contract negotiation and approval phase of these proceedings (Exh. DPU-DSM-60).

#### c. Net-to-Gross Ratios

The Companies proposed to apply default net-to-gross ratios<sup>21</sup> for each DSM technology to determine the level of savings to be used in calculating the lifetime net benefits which are used to determine the cost-effectiveness of a program (Exh. C-DSM-7, at 19). These default ratios were developed to account for anticipated levels of free ridership, free drivership, and snapback, and to ensure that all proposals are evaluated equally (*i d.*).<sup>22</sup> The net-to-gross ratios reflect the difference in savings between customers participating in a particular program and an equivalent group that is not participating (a control group), for

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<sup>21</sup> Net-to-gross ratios are used to adjust gross energy savings estimates, which are typically based upon average savings times the number of installed measures (Exh. C-DSM-5, at 9).

<sup>22</sup> The net-to-gross ratios for new construction programs are assumed to be 1.0, because the default savings estimates for these programs are based on construction practices that exceed code efficiency without utility or third-party programs or payments, and thus incorporate free riders, free drivers, and snapback (*i d.*).



each category of DSM measures (Exh. C-DSM-5, at 9). Since the Massachusetts societal cost-effectiveness test is based on benefits associated with net energy savings, gross savings estimates must be adjusted by net-to-gross ratios (i.d.). If a bidder can adequately demonstrate that a particular measure's net-to-gross ratio will differ substantially from the default assumptions, the bidder's ratios may be used to calculate cost-effectiveness for that measure (i.d. at 10). The Companies plan to apply the default net-to-gross ratios to their own programs (Exh. DPU-DSM-75).

To provide standard gross savings estimates to which the net-to-gross ratios would be applied, the Companies proposed to include an appendix to the RFP that would list default values for measure lifetimes and operating hours (Exh. C-DSM-5, at 8). If a bidder demonstrates through documentation a bid proposal or during contractual verification procedures that the technical parameters in a project will differ significantly from the default assumptions, the bidder's estimated actual lifetimes and/or operating hours may be used in calculating cost-effectiveness (i.d. at 9). Consistent with this provision, the Companies will apply the default measure lifetimes and operating hours to their own programs except in those instances where they can document in their bid submittal that the default ratios are inappropriate (Exh. DPU-DSM-76).

d. Bandwidth Cost-Effectiveness Methodology

The Companies proposed to use a bandwidth methodology to determine the cost-effectiveness of a project (Exh. DPU-DSM-78). In this methodology, a range of values was developed for each of several variables that were used in the B/C ratio calculation, in order to account for the variability and uncertainty in the B/C ratio (Exh. DPU-DSM-RR-28). For

example, a range of projected savings from a measure would be documented, a base case would be chosen, and high and low cases would be determined from the outer portions of the range (i.d.). The Companies proposed to use information from the bidders, from other utilities, and from other external sources to develop the range of values required to calculate a bandwidth (i.d.).

Where there is adequate information available, the Companies proposed to use the bandwidth methodology to determine a program's cost-effectiveness only in the threshold analysis, in the event that there is only one proposal in a market segment, or if all proposals have B/C ratios less than 1.0 (i.d.). The Companies testified that applying a bandwidth approach to a program with a B/C ratio of slightly less than 1.0 might allow a bidder into the negotiating group where the program could be made more cost-effective through optimization of the bid (Tr. 4, at 124-126). The Companies stated that they would prefer to err on the side of inclusiveness in this fashion rather than to exclude a potentially viable program from the negotiation process (i.d. at 126).

e. Administrative Costs

Among the costs that the Companies proposed to include when calculating cost-effectiveness are administrative costs including marketing, contract management, and measurement and verification ("M&V") (Exh. C-DSM-7, at 19). The Companies determined that the first two types of administrative costs are roughly equal across third-party programs, their own programs, and customer projects; thus, the Companies proposed to determine these costs and assign them on an equal basis to all proposals when evaluating cost-effectiveness (i.d.). M&V costs are divided into two components: (1) those costs incurred by the

Companies to ensure that installations, verifications, operations and maintenance procedures, and measure persistence are consistent with a given contract for DSM services; and (2) those costs borne by bidders in providing the level of M&V consistent with their bids (see Section IV.C.1, infra) which would be internalized in the bid price (i.d., at 19-20). The Companies have differentiated their own M&V costs by rate class, but not by market segment or by bid level of M&V (Tr. 3, at 133). That is, in determining cost-effectiveness, the Companies proposed to apply the same level of costs to each bid addressing the medium/large C&I sector, whether for a retrofit or a new construction program, and regardless of the level of M&V proposed by a bidder (i.d. at 134). See Section IV.C, infra. The Companies stated that this method was chosen because they were not able to quantify the trade-off between a higher bid level of M&V and the Companies' own costs to monitor and verify the savings from a particular project (i.d.).

The Companies have not proposed to include the costs of designing their own programs in the cost-effectiveness tests (Tr. 4, at 28). The Companies testified that they view Initial Resource Portfolio development costs as "sunk" costs to be recovered through the CCs, but not to be included as a cost in the B/C analyses either for their own programs or for bidder-proposed programs (i.d. at 27-28). The Companies have included most of these costs in the budget for July 1, 1993 through June 30, 1994; thus, they are already recovering program development costs through the current CCs (i.d. at 32-34). The Companies testified that they felt it was appropriate to recover all costs associated with the development of the

RFP and the Companies' Initial Resource Portfolio on a current basis<sup>23</sup> because the Companies are required by regulation to design broad-based cost-effective programs for all customer segments (i.d.). The Companies stressed that this is an obligation not shared by bidders (i.d.). Thus, to provide a level playing field, the Companies stated that they should not be penalized by having these costs attached to their programs when evaluating the cost-effectiveness of those programs (i.d. at 34).

On brief, the Companies argue that they have made the Initial Resource Portfolio available to all prospective bidders and have encouraged bidders to use designs included in the Initial Resource Portfolio or to offer improved designs in their bids; thus, all potential bidders have benefited from the Companies' program development work (Companies' Brief at 61). In addition, the Companies cite several Department Orders where the recovery of program development costs has been allowed (i.d., citing Berkshire Gas Company, D.P.U. 90-121, at 266 (1990); Western Massachusetts Electric Company, D.P.U. 89-260, at 88-89 (1990).

## 2. Position of MASSPIRG

### a. Avoided Costs

MASSPIRG agrees with the Companies' proposal to provide avoided cost information to the bidders at the time the RFP is issued (MASSPIRG Reply Brief at 7). MASSPIRG acknowledges the risk that some bidders may use the information to bid closer to avoided

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<sup>23</sup> When asked, the Companies agreed to consider recovering the program design consultant's expenses over a period of greater than one year to reflect the fact that savings associated with this work would be procured over a period greater than one year (i.d. at 30-31).

costs than they would otherwise, but MASSPIRG sees a greater risk of cream-skimming or a chipping of the market if avoided costs are not provided (i.d.). In addition, MASSPIRG cites the competitive advantage held by the Companies, who have access to the avoided cost information for the development of their own programs, if the same information is not made available to all bidders (i.d.).

b. Program Development Costs

MASSPIRG asserts that the costs incurred by the Companies to develop their own programs should not be included in the CCs unless those programs are selected and implemented (MASSPIRG Reply Brief at 7). MASSPIRG argues that to allow recovery of these costs would unfairly subsidize development of the Companies' programs with ratepayer money to the competitive disadvantage of bidders (i.d.). MASSPIRG also contends that ratepayers should not have to pay for development of a program that never serves them (i.d.).

3. Standard of Review

The I&M regulations require electric companies to develop an initial resource portfolio which includes cost-effective DSM programs for all customer sectors and subsectors and that avoid lost opportunities and cream-skimming. 220 C.M.R. § 10.03(5)(a)5. In D.P.U. 86-36-F at 19, the Department found that a DSM program is cost-effective if the cumulative net present value of the program's benefits exceeds the cumulative net present value of its costs, i.e., if the B/C ratio is greater than 1.0. In D.P.U. 86-36-F at 20-24, the Department set forth standards for DSM program cost-effectiveness and required an electric company to include the following elements in its cost-effectiveness test: (1) the full incremental cost of the DSM measure, regardless of who pays that cost; (2) all administrative

costs incurred by a company that can be attributed to a given program; (3) any quantifiable and significant end-user benefits; and (4) avoided environmental externalities. In Massachusetts Electric Company, D.P.U. 89-194/195, at 107-113 (1990), the Department refined its cost-effectiveness test to include free-rider and snapback effects. In Western Massachusetts Electric Company, D.P.U. 89-260, at 16-17 (1990), the Department further refined its cost-effectiveness test to include monitoring and evaluation costs. Regarding the recovery of program development costs, in Nantucket Electric Company, D.P.U. 91-106/138 (1991), the Department found that the company was entitled to collect expenditures associated with the development of its DSM programs. Id. at 31-32.

#### 4. Analysis and Findings

##### a. Societal Cost-Effectiveness Test

The Companies have appropriately proposed to use the Massachusetts societal cost-effectiveness test to evaluate the B/C ratios for all proposals, including their own. In calculating B/C ratios, the Companies propose to include all costs associated with each project and all benefits, including environmental externalities. They have assigned 35 points to this attribute out of a total of a possible 100 points, with the proposal in each market segment that has the highest B/C ratio to receive 35 points, and with the others in that same segment being ranked through linear interpolation down to zero for a B/C ratio of 1.0. The Companies testified that this methodology was designed to foster competition within each market segment and to discourage cream-skimming. The Department finds the Companies' proposal for this attribute, including the scoring methodology, to be appropriate. Accordingly, the Department accepts the design of the cost-effectiveness attribute as

proposed by the Companies.

b. Avoided Costs

The Companies have followed Department precedent by including all appropriate costs in the calculation of the avoided costs they have used to determine the cost-effectiveness of proposals. At issue is whether they should provide levelized avoided costs to bidders along with the RFP so that bidders can tailor their proposals to pass the cost-effectiveness threshold, while at the same time meeting the thresholds for comprehensiveness and program performance. The Companies stated that a market barrier to competition could result if the Companies did not provide avoided costs to bidders. The Companies also testified that there were enough safeguards built into the RFP to avoid "gaming" by bidders who might bid just below the level of avoided costs. The Companies asserted that competition with other bidders as well as with their own programs should be a deterrent to such a practice, and an incentive to submit least-cost proposals.

Arguments against providing avoided costs to bidders with the RFP were based on the assumption that bidders would bid up to the level of avoided costs, thereby resulting in higher bid prices than might be submitted if avoided cost information is not published. The only evidence submitted in this case was not sufficient to support conclusions on this issue. In the case of the Central Maine Power RFPs (one RFP included avoided costs and a second did not), bid prices in the second round tracked CMP's lower avoided costs, even though avoided costs were not provided to bidders. One cannot conclude, therefore, that it was the lack of published avoided cost information that was responsible for the lower bids.

Through this RFP, the Companies are soliciting bids for comprehensive programs in a

multitude of market segments, including several segments where B/C ratios of programs have historically been close to 1.0. Without having avoided cost information before preparing their bids, bidders may not be able to structure cost-effective proposals, thereby providing an unfair competitive advantage to the Companies' proposals.

The Department has some concern that providing avoided cost information will lead to bids that closely track avoided costs. However, given that the Companies are seeking energy savings only, and that the avoided costs are primarily avoided energy costs, the chances of attracting over-priced bids is minimal, and the opportunity for bidders to submit cost-effective proposals is enhanced. Accordingly, the Department finds that, in this instance, and for this RFP only, the provision of ten-year levelized avoided cost information to bidders at the time of issuance of the RFP is appropriate. Therefore, the Department accepts the Companies' proposal.

c. Net-to-Gross Ratios

The Companies' use of net-to-gross ratios to determine the present value of the savings component of a proposal is an attempt to more closely approximate the true value of program savings than would result from the use of gross savings estimates. Since the societal cost-effectiveness test is based on benefits associated with net energy savings, the net-to-gross ratios provide some measure of assurance that a program will be cost-effective even when effects such as free riders and snapback are taken into account. By applying the same ratios to all bids -- including their own -- the Companies are creating a level playing field in this regard. At the same time, they allow for flexibility when a bidder can show that a particular measure's net-to-gross ratio differs substantially from the default ratio. These



ratios will not be used as the basis for payment, but only as the basis for determining cost-effectiveness in the resource selection process in a particular market segment.

The Companies will provide an appendix to the RFP which lists the default net-to-gross ratios as well as default measure lifetimes and operating hours. As long as the same values will be used to determine savings estimates for all bidders, bids will be ranked consistently on the cost-effectiveness attribute. Accordingly, the Department accepts the Companies' proposal regarding net-to-gross ratios and default measure lifetimes and operating hours.

d. Bandwidth Cost-Effectiveness Methodology

The Companies propose to use the bandwidth methodology primarily to allow a marginally cost-effective proposal to be admitted to the negotiating group where it might be made more cost-effective. This approach could serve to expand the pool of bids from which winning projects could be selected. However, because the Companies will be providing their avoided cost information to bidders, along with a list of net-to-gross ratios and measure lifetimes and operating hours, bidders should be able to optimize their bids themselves, and no bid with a B/C ratio of less than 1.0 should be submitted. Accordingly, the Department finds that the Companies should not apply a bandwidth methodology in determining the cost-effectiveness of a proposal, and should delete all references to same from the RFP.

e. Administrative Costs

The Companies have appropriately included their administrative costs in the cost-effectiveness test and have allocated these costs appropriately to bids other than their own as well. Their assumption that the costs would be comparable for all programs is reasonable.

absent evidence to the contrary. Accordingly, the Department accepts the Companies' proposal regarding the treatment of administrative costs in the cost-effectiveness test for this RFP.

However, the Department has some concerns with the Companies' proposal to add the same M&V cost to each bid in a particular market segment regardless of the level of M&V proposed by bidders. The Companies have testified that their own costs would be higher when a lower level of M&V is provided by a bidder, but they were unable to quantify the relative difference. They stated that the response to this first RFP of its kind should provide the kind of information that will allow them to make more subtle distinctions in future solicitations. While the Department accepts the Companies' proposal for treatment of the Companies' M&V costs for this RFP only, we expect that once sufficient information on the variability of these costs has been determined, the Companies will propose to differentiate their costs based on differing levels of M&V bid.

As far as including their own development and design costs in the cost-effectiveness test, the Companies have treated these costs as "sunk" costs that should not be used to determine whether a program would be cost-effective on a "to go" basis. In addition, the Companies argue that to add these development costs to the cost side of the Companies' B/C ratios would disadvantage the Companies, who, unlike other bidders, were obligated to develop program designs for all customer segments, to develop the RFP, and to litigate the form and content of it. The Companies have included most of these costs in the CCs that are currently being collected from ratepayers.

MASSPIRG contends that no program design costs should be included by the

Companies in the CCs unless a particular program of the Companies is an award winner and is subsequently implemented. MASSPIRG does not comment on the Companies' proposal to exclude program development costs from the cost-effectiveness analysis.

The Department finds it appropriate for the Companies to exclude their own program development costs from the cost-effectiveness analysis when determining whether a program is cost-effective on a "to-go" basis. The Department also agrees with the Companies that, unlike all other bidders, they have a unique obligation to design programs for every customer sector and to submit these designs as an Initial Resource Portfolio along with the RFP for review by the Department. 220 C.M.R. § 10.03(5)(a)5.

The IRM regulations mandate that electric companies develop and submit DSM program designs targeting all customer sectors at the time of submission of an RFP soliciting energy savings. Department precedent allows utility companies to recover documented litigation and regulatory expense through rates. See, for example, Bay State Gas Company, D.P.U. 92-111, at 208-209 (1992). Accordingly, the Department finds that it is appropriate to allow the Companies to recover the costs incurred to develop and litigate the RFP issues, as well as to design the DSM programs included in their Initial Resource Portfolio, through the rate category-specific CCs. The Companies must submit calculated CCs based on the contracts negotiated with the final award group winners when they submit these contracts for approval in Phase IV of these IRM proceedings.

The Department notes that the Companies are already recovering most of their program development costs through currently effective CCs. The Companies stated their willingness to amortize some of these expenses, if ordered to do so. The Department

declines to order amortization of these development costs in the instant case, because these costs were approved for recovery in the Companies' most recent DSM case, D.P.U. 93-15/16, and to order amortization at this time would add carrying costs in future years, thereby decreasing the amount in the budgets available to be applied to program implementation.

### C. Program Performance

#### 1. The Companies' Proposal

The Companies stated that the program performance attribute measures the likelihood that a program will perform as represented in the bid proposal, and the degree of protection a proposal provides the Companies' ratepayers in instances where service providers (*i.e.*, the winning bidders) do not perform in accordance with the terms of the bid proposals (Exh. C-DSM-7, at 47). A proposal is eligible to receive a maximum of 20 points for this attribute, divided into three categories: (1) a maximum of thirteen points may be awarded to proposals based on the level of pre- and post-installation measurement activities indicated in the M&V plans submitted with the proposals; (2) two points may be awarded to those proposals that reflect consistent use of preferred standard equipment, as described by the Companies; and (3) a maximum of five points may be awarded to proposals based on the degree of linkage between performance and payments to service providers (*i.d.* at 48-54; RR-DPU-DSM-25).<sup>24</sup>

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<sup>24</sup> The program performance scoring system described here represents the Companies' revision to their initially-proposed scoring system. The initially-proposed scoring system called for (1) a maximum of ten points for M&V plans, (2) five points for equipment standards, and (3) a maximum of five points for payment linkage

The first scoring category for program performance evaluates the M&V plans that bidders are required to include in their proposals. The M&V plans must clearly indicate the procedures to be used to establish baseline (i.e., pre-DSM measure installation) energy usage and operating characteristics, and to verify post-installation energy and demand savings (Exh. C-DSM-7, at 48). For proposals targeting the small and medium/large C&I retrofit markets, there are three scoring levels for M&V plans (i.d.). The threshold level, Level I, requires, for each end use, (1) engineering estimates of all savings (weather adjusted, where appropriate), prepared by a Massachusetts Registered Professional Engineer and (2) pre-installation metering of hours-of-use. An M&V plan that includes this level of activities would receive zero points (i.d. at 50). To qualify as Level II, an M&V plan would be required to include Level I activities plus pre-installation metering of demand usage. An M&V plan that included this level of activities would receive five points (i.d.). Finally, to qualify as Level III, an M&V plan would be required to include Level II activities plus post-installation metering of energy and demand usage. An M&V plan that included this level of activities would receive thirteen points (i.d.; RR-DPU-DSM-25).

For proposals targeting the residential retrofit markets, the number of M&V scoring levels depends on the end use. For building envelope and thermostatic control end uses, there are two scoring levels for M&V plans (Exh. C-DSM-7, at 51). The threshold level,

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(Exh. C-DSM-7, at 49). The Companies stated that, to satisfy the Department's objectives regarding performance-based payments, they have reallocated three points from the equipment standards category to the M&V plan category, to be awarded to those proposals that conform to the highest M&V standards in each market segment (RR-DPU-DSM-25).

Level I, requires (1) on-site infiltration testing, and (2) engineering savings estimates based on the Degree Day Analysis Method. An M&V plan that includes this level of activities would receive zero points (i.d.). To qualify as Level II, an M&V plan for these end uses would be required to include (1) on-site infiltration testing, and (2) engineering savings estimates based on the Variable Degree Day Method.<sup>25</sup> An M&V plan that includes this level of activities would receive thirteen points (i.d.; RR-DPU-DSM-25).

For all other residential retrofit end uses,<sup>26</sup> there is only one scoring level for M&V plans (Exh. C-DSM-7, at 51-52). The threshold for these end uses requires that engineering savings estimates be reviewed and adjusted as necessary by the Companies. Proposals that meet the threshold requirement for these end uses would receive thirteen points (i.d.; RR-DPU-DSM-25).

For proposals targeting the new construction markets, both residential and C&I, there is only one scoring level for M&V plans (Exh. C-DSM-8, at 32-33). The M&V threshold for new construction requires that (1) baseline energy and demand usage be determined using existing building codes and standards, and (2) engineering estimates of post-installation savings be prepared by a Massachusetts Registered Architect or Professional Engineer and approved by the building owner and the Companies. Proposals that include this level of M&V activities would receive thirteen points (i.d.; RR-DPU-DSM-25).

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<sup>25</sup> The Variable Degree Day Method is a more sophisticated model for heat loss calculations than the Degree Day Analysis Method (for a description of the two models, see Tr. 4, at 115-116).

<sup>26</sup> These end uses are lighting, domestic water heating, and refrigeration and air conditioning.

The Companies maintain that the M&V thresholds were based on industry experience, including data from the Association of Energy Engineers (Companies Brief at 19). The Companies contend that the thresholds remove market barriers to participate in the RFP in that they provide bidders with the flexibility to determine the level of M&V activities they are able to provide (i.d.). The Companies also contend that the M&V scoring structure provides an appropriate incentive for bidders to include more rigorous M&V protocols. They assert that the scoring structure "allows the market to determine the appropriate trade-offs between receiving a higher score in the program performance attribute versus foregoing points in the cost-effectiveness attribute to the extent that greater verification results in higher costs and bid prices" (i.d. at 18).

The second scoring category for program performance evaluates the equipment standards contained in each bid proposal and is worth two points. The Companies state that they developed threshold and preferred equipment standards for five technology classes: controls, building improvements, lighting, motors, and variable frequency drives (Exh. C-DSM-8, App. B). The Companies assert that the purpose of awarding points to proposals that meet the preferred standards is to "maximize long-term customer satisfaction; to obtain energy efficiency improvements, and to attain the persistence of savings necessary to ensure cost-effectiveness" (Companies Brief at 19).

The third scoring category for program performance evaluates the amount of linkage between payments to service providers and the results of the service providers' M&V

activities, as specified in the project-specific M&W memoranda,<sup>27</sup> and the Companies' pre- and post-installation verification activities (Exh. C-DSM-7, at 49). As a threshold requirement, bidders that propose medium/large C&I retrofit programs are required to spread the recovery of at least 50 percent of their total payments over a seven-year period, up to a maximum of 70 percent of total payments (i.d. at 50-51). Bidders that propose small C&I retrofit programs are required to spread the recovery of at least 30 percent of their total payments over a three-year period (i.d.). There are no such threshold requirements for proposals targeting the residential retrofit and the new construction markets (i.d.). Proposals that exceed the minimum requirements (i.e., those that spread a higher percentage of total payments over the program term) receive up to a maximum of five points (i.d.).

The Companies assert that an important element in the RFP is the requirement that payments be linked to performance (Companies Brief at 20-21). They maintain that, at a minimum, no payments will be made to service providers until measure installation verification is complete (i.d.). The Companies contend that the appropriate level of payments to service providers that is required to be spread over the program term is dependent upon the market sector being considered. They assert that overly stringent payment thresholds for certain market segments, such as the new construction and residential retrofit sectors, could exclude potentially cost-effective proposals (i.d.). The Companies note that, in addition to performance-based payments, the RFP includes provisions for completion, persistence, and

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<sup>27</sup> Proposals may be comprised of several individual projects. Proposals that are included in the final award group are required to submit project-specific M&W memoranda for the Companies' approval. The project-specific M&W protocols must be consistent with the procedures included in the proposals' overall M&W plans (Exh. C-DSM-7, at 50).



front-loading security, so that ratepayers are financially protected in instances where a service provider does not perform in accordance with the terms of the bid proposal (i.d.).

## 2. Standard of Review

The Department has previously stated its policy objective of having electric companies move toward performance-based cost recovery of DSM expenditures. Western Massachusetts Electric Company, D.P.U. 89-260, at 93 (1990); Massachusetts Electric Company, D.P.U. 89-194/195, at 150 (1990). Most recently, the Department stated that, as preapproval of DSM resources takes place in the context of electric companies' IRM proceedings, service providers, including the electric companies, will be expected to propose cost-recovery mechanisms in which payments are linked to verified and measured performance criteria. See Boston Edison Company, D.P.U. 90-335, at 138 (1992).

## 3. Analysis and Findings

The Department must determine whether the Companies' program performance attribute satisfies the policy objective of performance-based payments to service providers. Program performance can be measured using different M&V techniques. One M&V technique requires verification that (1) baseline energy and demand usage data are determined in an appropriate manner, (2) engineering estimates of the performance of installed DSM measures are determined in an appropriate manner, and (3) all DSM measures are installed properly and as indicated in the project specifications. The Companies require that proposals targeting all market sectors include at least this level of M&V activities.

A more rigorous performance M&V technique employs metering devices to measure pre- and post-installation energy and demand usage. For proposals targeting the small and

medium/large C&I retrofit markets, this level of M&W activity would be classified as a Level III M&W plan and would receive the highest points in the M&W scoring category.

An objective of this competitive solicitation is to acquire information about the levels and costs of DSM services that can be obtained from the competitive marketplace. The Department recognizes that, to be successful in this objective, the program performance thresholds must be established so as to strike a balance between encouraging a broad range of service providers to participate in the solicitation and protecting ratepayers against the risks of inadequate performance. In addition, the Department recognizes that the program performance scoring criteria must send the appropriate signals to bidders regarding the importance of various levels of M&W activities so that bidders may weigh the tradeoff between receiving a higher score in the program performance attribute versus incurring additional costs and risks associated with more rigorous M&W activities.

The Department finds that the Companies' program performance thresholds appropriately strike the balance described above. The thresholds ensure that no payment will be made to service providers until the Companies verify that savings estimates are determined in an appropriate manner and that DSM measures are installed properly. All payments may be adjusted to reflect the results of the Companies' verification activities. At the same time, the thresholds allow service providers who are not capable of providing sophisticated metering services and who require a certain level of front-loaded payments (i.e., payments that are not spread over the program term) to participate in the RFP.<sup>28</sup> The

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As stated above, proposals targeting the small and medium/large C&I retrofit markets are required to spread the recovery of at least 30 and 50 percent, respectively, of their

Department notes that the RFP's security requirements protect ratepayers against front-loaded payments to service providers (see Section VII.A, infra).

The Department further finds that the program performance scoring criteria send the appropriate signals to bidders regarding the value associated with more rigorous and more precise M&V techniques. For example, in the C&I retrofit markets, proposals would be awarded five points for including Level II M&V plans and thirteen points for including Level III M&V plans. The Department notes that service providers who provide pre- and post-installation metering activities that exceed the threshold requirements incur additional costs associated with the more rigorous metering activities (i.e., the cost of installing and maintaining the metering equipment). In addition, these service providers bear greater performance risks associated with the more precise M&V techniques. The Department finds that the additional points awarded to Level II and III M&V plans allow proposers to weigh appropriately the tradeoffs between higher scores in the M&V category and the associated higher costs and risks.

In the residential retrofit market (with the exception of building envelope and thermostatic control end uses) and the new construction market, no additional points would be awarded to proposals that exceed the threshold M&V activities. The Companies testified that, based on their experience and the experience of their consultants, they determined that it is unlikely that bidders in these markets would be able to provide M&V activities that exceed the threshold levels in a manner that would provide real value to their ratepayers (Ir. 1,

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total payments over the program terms. There are no such requirements for proposals targeting the residential retrofit and the new construction markets.

at 109-113; Tr. 2, at 66-70). The Department finds that, because of the importance of ensuring that winning proposals are viable and, thus, will provide real value to ratepayers,<sup>29</sup> the M&W scoring criteria for these markets are acceptable. With respect to building envelope and thermostatic control end uses in the residential retrofit market, the Department finds that the thirteen points that would be awarded to proposals that utilize the more sophisticated Variable Degree Day Method appropriately reflects the value provided to ratepayers through the more precise heat-loss calculations provided by this model.

With respect to the scoring category which assesses payment linkage, the Department finds that the points that would be awarded to proposals that exceed the minimum requirements for payment linkage (i.e., those that spread a higher percentage of total payments over a program's term) appropriately reflect the additional value these proposals would provide to ratepayers. The Department finds that the maximum of five points that is available in this category allows bidders to weigh appropriately the trade-off between higher scores in this category and the additional performance risks (because payments are based on the results of the bidders' and the Companies' M&W activities) associated with spreading payments over the program terms.

Finally, the Department finds that the two points awarded to proposals that meet the preferred equipment standards developed by the Companies appropriately reflect the added value that programs that exceed the threshold equipment standards would offer ratepayers.

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<sup>29</sup> The Department notes that, because this is the first comprehensive DSM RFP implemented in Massachusetts, it is particularly important to ensure the viability of the winning proposals.

Based on the analysis provided above, the Department finds that the Companies' program performance attribute satisfies the policy objective of performance-based payments to service providers. Accordingly, the Department accepts the program performance thresholds and scoring criteria as proposed.

D. Marketing Plan

1. The Companies' Proposal

The marketing plan attribute measures the likelihood that program bids will be able to successfully target and reach customers (Exh. C-DSM-5, at 14). The Companies proposed to award 15 points to those bidders whose proposed marketing plans meet standards in the following criteria: customer acceptance, market research and validity, target market and saturation, appropriateness of promotional tactics, controls and continuity, and whether or not the plan targets "hard-to-reach" customers (Exh. C-DSM-7, at 54-55).

"Customer acceptance" is qualitatively assessed based on whether or not the proposed measures are likely to be acceptable to customers. This criterion is worth four points (i.d.). Bidders who provide signed contracts and/or letters of intent to implement DSM measures in customer facilities will be scored more favorably on this criterion (i.d.). "Market research and validity" refers to the quality of the market potential analysis provided by a bidder and is worth up to two points (i.d. at 55-56). "Target market and saturation plans" are evaluated based on plans for penetrating a given market sector and proposals for marketing the proposed DSM measures to targeted customers. This criterion is worth up to two points (i.d.). "Appropriateness of promotional tactics" measures the degree to which the proposed promotional tactics are reasonable with regard to the customers targeted and the DSM

measures proposed. This criterion is worth one point (id.). "Controls and continuity" includes the procedures used to measure and control the progress of program implementation and includes milestones for program completion. This criterion is worth one point (id.). With respect to the milestone schedule, the Companies indicated that should Company bids be selected, they would be subject to the same performance milestones as would third party bidders (Companies Reply Brief at 6-7).

The remaining five points to be awarded are based on the degree to which the plan targets "hard-to-reach" customers (Exh. C-DSM-7, at 56). The Companies define "hard-to-reach" customers as the following: residential low-income, public housing, multi family, rental properties, elderly, schools, and government facilities (Exh. C-DSM-5, at 16).

## 2. Standard of Review

In D.P.U. 86-36-F, the Department required electric companies to analyze DSM potential in each sector, analyze market barriers to customer participation in cost-effective DSM opportunities, and design programs that overcome those market barriers at the lowest possible cost to ratepayers overall. Id. at 26. In addition, the Department specified that companies should pay "particular attention" to hard-to-reach sectors including low-income residential customers, rental housing, small commercial customers and institutions. Id. at 26-27.

Regarding milestone schedules, the Department has determined that "in order to prepare a viable [project] proposal, a developer would have to consider carefully the maximum amount of time that would be needed to complete each stage of a proposed project." Boston Edison Company, D.P.U. 90-270, at 158-159 (1991). The Department

found that a milestone schedule is an appropriate indicator of whether a project proposal is viable, and should be included as a threshold requirement. Id. at 159. In addition, the Department found that it was appropriate to award points for a developer's willingness to accept penalties for failing to meet a milestone schedule. Id.

### 3. Analysis and Findings

The purpose of this section is to determine whether the Companies' proposed marketing plan attribute fulfills the requirements outlined in the Department's IRM regulations and is consistent with Department precedent regarding DSM and supply-side resource procurement.

A threshold for "controls and continuity" requires that bidders submit a milestone schedule along with plans for controlling the progress of program measure implementation. The Department notes that in the absence of any explicit penalties associated with the milestone schedule, there is an incentive for a bidder to propose an overly ambitious implementation schedule to achieve a higher ranking, without the ability to meet this schedule once the implementation begins. The Department finds that bidders could be awarded contracts in part based on an ambitious implementation schedule which they cannot achieve, resulting in customers not receiving DSM services and projected savings not being realized in a timely manner. Therefore, the Companies are directed to require a linkage between the return of project completion security to bidders and the milestone schedule such that financial penalties will accrue to bidders who are unable to meet their proposed milestone schedule. See Section VII.A.1., infra. With this single exception, the Department finds that the structure and weighting of the marketing plan is appropriate and accepts it as proposed.

## E. Comprehensiveness

### 1. The Companies' Proposal

The Companies have included comprehensiveness as one of the attributes in the ranking system in order to credit programs that produce comprehensive DSM projects and avoid lost opportunities (Exh. C-DSM-7, at 23). Comprehensiveness was assigned a relative weight of ten percent for the purpose of ranking proposals (i.d. at 14).

The Companies stressed that this attribute is difficult to score quantitatively, since attaining comprehensiveness and avoiding lost opportunities requires a unique set of program characteristics in each market segment (i.d. at 57). For this reason, the Companies have defined the minimum thresholds and scoring criteria for the comprehensiveness attribute separately for each market segment (i.d.). The Companies' proposed RFP provided detailed tables indicating the end uses and technologies that constitute market segment thresholds and that will be used for scoring proposals that meet the thresholds (i.d. at 59-64).

The Companies stated that the threshold levels for the comprehensiveness attribute were established to ensure that proposed programs will not lead to any significant lost opportunities, and that the scoring criteria for this attribute were established to credit programs that include comprehensive DSM projects (Tr. 1, at 141-142). The Companies proposed to score comprehensiveness in two parts. In the first part, up to eight points will be awarded based on a qualitative assessment of (1) the width and depth of proposals,<sup>30</sup>

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<sup>30</sup> The "width" of a proposal measures the range of end uses treated with a facility (Exh. C-DSM-5, at 17). The "depth" of a proposal measures the comprehensiveness of technologies to be applied within a particular end use (i.d.).



(2) the adequacy of monitoring and evaluation plans to verify comprehensiveness, and (3) the linkage of contract payments to the comprehensiveness of installations at relevant facilities (Exh. C-DSM-5, at 18). In the second part of the scoring, up to two points will be awarded based on the breadth of market coverage of proposals (id.). The Companies stated that this two-part approach recognizes that it is important that proposals not only claim, but also guarantee, that installations will be comprehensive (id.).

## 2. Standard of Review

The Department's IRM regulations require that a company's ranking system evaluate the quality of output or savings. 220 C.M.R. § 10.03(10)(d)3. For DSM projects, this component of the ranking system must include consideration of the degree to which projects address cream-skimming and lost opportunities. Id.

## 3. Analysis and Findings

The Department finds that the Companies' comprehensiveness attribute appropriately addresses lost opportunities as a threshold issue, and provides for the review and crediting of programs that are more comprehensive than other proposals in the same market segment. The Companies have included a detailed and clear presentation of the factors to be considered and the method that will be used in evaluating proposals with respect to the comprehensiveness attribute. Therefore, the Department finds that the Companies' comprehensiveness attribute, and the presentation of its scoring procedure, complies with the relevant portions of the IRM regulations. Accordingly, the Department accepts the comprehensiveness attribute as proposed by the Companies.

## F. Proposer Qualifications and Financial Strength

### 1. The Companies' Proposal

The Companies proposed to award up to ten points, evenly divided, to bidders based on their proposer qualifications and financial strength (Exh. C-DSM-5, at 21). The specific criteria to be evaluated under proposer qualifications include success with similar programs/projects, relevant experience, customer satisfaction and quality assurance, and program staffing (Exh. C-DSM-7, at 66-67). The "success with similar programs" criterion refers to a bidder's experience with other DSM competitive solicitations (Ir. 1, at 145). The "relevant experience" criterion refers to all other experience which a bidder possesses that may contribute to the ultimate success of the program (*id.* at 145-146). The "customer satisfaction and quality assurance" criterion refers to a bidder's demonstrated ability to ensure customer satisfaction and quality assurance and contains a provision that proposals include procedures for addressing customer complaints (Exh. C-DSM-7, at 67). The "program staffing" criterion refers to a bidder's responsibility to specify qualified personnel for key functional areas such as marketing and implementation (*id.* at 66). Within each market segment, the program exhibiting the strongest bidder qualifications will be awarded five points, the weakest will receive zero, and proposals which lie in between will receive points based on linear interpolation. (Exh. C-DSM-5, at 21).

The financial viability of both the bidder and the proposal will be considered (Exh. C-DSM-7, at 67). The financial strength of the bidder will be evaluated based on audited financial statements and "conventional financial indicators" (Ir. 1, at 147-148). The financial viability of the proposed program will be judged based on pro forma cash flow

statements for the program and its congruence with the bidder's financial strength (Exh C-DSM-7, at 68). In addition, bidders who demonstrate through signed letters of commitment or equivalent documentation that they have obtained financing for a proposed program will be awarded more points (id.). Linear interpolation will be applied for financial strength in the same manner as indicated for bidder qualifications, above, (Exh. C-DSM-5, at 21).

## 2. Standard of Review

The Department has specified in the IRM regulations that the experience of the project developer shall be considered. 220 C.M.R. § 10.03(10)(d). Previous decisions of the Department have affirmed that bidder experience is an appropriate measure of potential project success. Boston Edison Company, D.P.U. 90-270, at 156 (1991). The IRM regulations also indicate that the likelihood of success of a project shall be evaluated based on financial arrangements completed and financial resources available, inter alia. 220 C.M.R. § 10.03(10)(d).

## 3. Analysis and Findings

The successful implementation of a DSM project will depend, in part, on the depth of the training and experience the bidder brings to that project. In light of the Companies' past performance, and the current economic difficulties of the region, it is particularly important that the opportunity to implement DSM measures be limited to experienced bidders. See Cambodge Electric Light Company/Commonwealth Electric Company, D.P.U. 92-218, at 9 (1993). DSM measures are fundamentally different from supply side projects in that they require bidders to market the product directly to the Companies' customers. Because these

measures will be installed in the homes and facilities of customers, it can be assumed that the customers will place a premium on quality and service.

The financial strength of both the project and the bidder is also of importance. The IMM regulations explicitly state that the financial resources of a bidder shall be used to evaluate the likely success of a project. By including a requirement that bidders provide financial projections for individual projects, the Companies should be able to determine the congruence of the project with the bidder. The failure of bidders to provide DSM services they have contracted to provide can have negative consequences. The immediate impact is that customers who were expecting DSM services may lose the opportunity to have these measures installed, thereby losing projected savings. In addition, should a bidder leave the market, the long-term effect would be to erode the DSM infrastructure which could reduce the competitiveness of future DSM solicitations. By evaluating the financial strength of a bidder and of each proposal, the Companies should be able to better determine the likelihood of a bidder's success in implementing the proposed program. The Department finds that the Companies' proposal regarding bidder qualifications and financial strength is appropriate and reasonable. Accordingly, the Department accepts the Companies' proposal regarding the structure and weighting of this attribute.

## G. Customer Contributions

### 1. The Companies' Proposal

The Companies proposed to ensure customer contributions<sup>31</sup> through minimum thresholds and a point system specific to the various market segments (Exh. C-DSM-7, at 69-70). The Companies proposed to require programs targeting the medium/large C&I class to include a minimum customer contribution of 20 percent of the total costs as defined for the cost-effectiveness analysis, with all costs expressed on a present value basis (*i.d.* at 69). The Companies also proposed to award up to ten points for proposals that incorporate a customer contribution that exceeds the minimum threshold up to a "scoring maximum" specified for each market segment (*i.d.* at 70).

The customer contribution scoring maximum is a pre-set cap on customer contributions based on a percentage of total costs for which the Companies would award points (*i.d.*). For example, two bidders that propose a customer contribution of 75 percent and 50 percent, respectively, in a market segment where the scoring maximum is 50 percent would both receive the maximum ten points associated with the customer contribution attribute (*i.d.*). The proposed customer contribution scoring maximum is 60 percent for medium/large C&I retrofit programs, 50 percent for medium/large C&I new construction

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<sup>31</sup> Customer contribution for proposals not made by customers of the Companies is defined as the proportion of the direct installed costs, including materials and installation labor, to be paid by customers receiving DSM measures through a proposed DSM program (Exh. C-DSM-7, at 69). For customer proposals, customer contribution is defined as the present value of all costs included within the cost-effectiveness analysis associated with the proposed project minus the present value of all payments made to the relevant customer by the Companies (*i.d.*).

programs, and 35 percent for all other market segments (i.d.). The scoring maximum is designed to discourage programs that incorporate unrealistically high expectations about attainable customer contributions (i.d.). For each market segment, ten points are linearly distributed between the threshold and the scoring maximum (Exh. C-DSM-5, at 23).

The Companies indicated that the minimum thresholds and the scoring maximums were derived through an extensive review of DSM programs in various parts of the country, and particularly those programs recently implemented and subject to regulatory scrutiny in Massachusetts and the New England region (Exh. DPU-DSM-19). The Companies also evaluated the minimum thresholds and scoring systems applied to customer contributions within the context of DSM RFPs, such as those issued by the Niagara Mohawk Power Company, Central Maine Power, and Orange and Rockland Utilities (RR-DPU-DSM-9).

The Companies indicated that no minimum customer contribution thresholds were set for any rate category except medium/large C&I because they did not want to discourage competition in response to the RFP (i.e., they did not want to limit the number of bidders responding) (Tr. 1, at 167). The Companies and their consultants stated that bidders in the DSM market are quite sensitive to a potential overload of bidding requirements (i.d. at 159). Rather than impose many requirements on bidders, the Companies stated that their proposed RFP provided sufficient incentive to bidders to seek out customer contributions (i.d. at 160).

Regarding the scoring maximums proposed, the Companies stated that they were particularly concerned about bidders who could not deliver the customer contributions that they bid (i.d. at 167). The Companies stated that they did not believe that the market could adequately regulate itself against bids that were overly optimistic (i.d.). The Companies also

stated that the scoring maximums were high enough to provide incentive to bidders to seek out the maximum realistic customer contributions (i.d. at 167-168).

## 2. Standard of Review

In Western Massachusetts Electric Company, D.P.U. 92-13, at 11 (1992), the Department directed WMECo to continue to actively investigate and implement increased customer contributions in its conservation programs. In Massachusetts Electric Company, D.P.U. 92-217 at 7 (1993), the Department reiterated its intent to increase customer contributions, stating that MECo's proposals to introduce customer contributions in the Residential Space Heating Program and to study the feasibility of implementing customer contributions in other programs were consistent with our policy as stated in D.P.U. 92-13.

## 3. Analysis and Findings

The Department finds that the Companies' proposal regarding customer contributions is reasonable and appropriate for the purposes of the instant proceeding. The Department, however, directs the Companies, for the purposes of their next ILM proceeding, to analyze the responses to the RFP and the actual implementation of DSM for the following considerations: (1) whether the minimum customer contributions can be increased without significantly reducing bidder response; (2) whether the maximum customer contributions can be increased without significantly increasing non-performance; and (3) whether the customer contribution minimums and maximums for each market sector should be developed as a function of the payback period on customer investments. The Department further directs the Companies to submit the results of this investigation in Phase I of their next ILM proceeding.

## V. RANKING SYSTEM AND PROJECT SELECTION PROCESS

### A. Introduction

Evident throughout the Department's Orders addressing resource procurement is the expectation that competitive processes will yield the lowest cost resources for ratepayers. See D.P.U. 89-239, at 1-5 (1990); D.P.U. 86-36-F at 37-48 (1988). However, the Department has recognized that a host electric company might have a substantial incentive to distort a resource solicitation so as to create a process that would result in the selection of its own resource proposal over proposals that would be selected through a truly competitive process. *Id.* 62-64. Accordingly, to ensure that fair, competitive solicitations occur, the IRM regulations call for the Department to review (1) prospectively, in Phase I of the IRM proceeding, an electric company's RFP(s) and resource selection process, then (2) retrospectively, in Phase III of the IRM proceeding, a company's implementation of the approved resource selection process and the resulting award group. 220 C.M.R. § 10.03; 220 C.M.R. § 10.05. This IRM review framework was carefully designed to: (1) balance the conflicting goals of providing for a flexible resource procurement procedure and ensuring that company decisions would be sufficiently reviewable to preclude host company self-dealing; (2) enable the Department to determine whether the resources to be preapproved represent the most reliable and least-cost resource mix; and (3) minimize and simplify future Department reviews of award-group ranking and disqualification disputes.<sup>32</sup>

This Section presents the Department's Phase I review of the Companies' proposed

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<sup>32</sup> See, e.g., D.P.U. 86-36-C at 111-112 (1988); D.P.U. 86-36-F at 61-64, 76-78; D.P.U. 86-36-G at 13-50 (1989); and D.P.U. 89-239, at 29-36.



project selection process, including a review of the appropriateness of the relative weights assigned to each of the RFP's project selection criteria (*i.e.*, the program attributes). For a presentation of the content, description, thresholds, and scoring procedures with each of the RFP's program attributes, see Section IV, *supra*.

B. The Companies' Proposal

1. Project Selection Process

The Companies proposed to implement identical and parallel project selection processes for Cambridge and Commonwealth that provide for direct competition between projects within each of eight market segments defined in the RFP (Exh. C-DSM-4, at 15). For each company, the eight market segments correspond to four major rate categories (residential non-heat, residential heat, small C&I, and medium/large C&I), with two market "types" (new construction and retrofit/equipment replacement) in each rate category (*i.d.*).

The Companies' proposed selection process is comprised of three components: (1) project screening; (2) project ranking and resource optimization; and (3) competitive negotiations (Exh. C-DSM-7, at 30-33).

The Companies proposed to first screen project proposals for clarity and completeness to ensure that they comply with the filing requirements of the RFP (*i.d.* at 30). Bidders would have the opportunity to respond within ten working days to any clarification requests issued by the Companies (*i.d.*). Projects would then be screened to determine if they meet the eligibility requirements and minimum thresholds for each program attribute specified in the RFP. Bidders who submit proposals that do not meet these requirements and/or thresholds would be notified of disqualification within 10 working days of the opening of the

proposal response package (i.d. at 31).

After screening, the Companies proposed to score each remaining proposal with regard to the six program attributes and to rank the proposals within each of the eight market segments according to total attribute score (i.d.). The Companies proposed to select projects in rank order from each market type (i.e. new construction and retrofit/replacement) within a given rate category until the total of annual payments over the proposed program terms reaches the preliminary budget allocation for that rate category (i.d. at 31-32).<sup>33</sup>

Following this initial ranking of projects, the Companies proposed to evaluate each proposal individually to determine how efficiently it would interact with other Company resources (Exh. C-DSM-2, at 13). This "optimization" process would address, in part, issues concerning comprehensiveness of the services that would be provided by the proposals and the potential for overlapping programs (Exh. C-DSM-7, at 32). The Companies expect that, since the RFP is for energy savings only, the effort necessary to optimize the Award Group would be minimal (Ir. 2, at 48-49).

The result of the screening, ranking, and optimization steps of the Companies' resource selection process would be a "preliminary negotiations group" for each rate category (Exh. C-DSM-7, at 32). The Companies intend to negotiate with every bidder in the preliminary negotiations groups with the goal of entering into a set of contracts that, as a whole, is most consistent with the RFP objectives and the final budget allocations for each rate category (i.d.).

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<sup>33</sup> Pursuant to 220 C.M.R. § 10.04(3), the preliminary budget allocation would be equal to 130 percent of the final budget allocation.

The Companies proposed to submit each negotiated contract to the Department for approval following the negotiation phase. The contracts would become effective upon Department approval (i.d. at 34).

## 2. Relative Weights of Program Attributes

The Companies proposed to conduct the initial ranking of project proposals within each market segment based on the six program attributes identified in the RFP. The attributes and their relative weights are as follows: (1) Cost-Effectiveness, 35 percent; (2) Program Performance, 20 percent; (3) Marketing Plan, 15 percent; (4) Comprehensiveness, 10 percent; (5) Proposer Qualifications, 10 percent; and (6) Customer Contribution, 10 percent (Exh. C-DSM-7, at 13-14). The attributes and relative weights are consistent across all market segments, but applicable thresholds and the method for scoring proposals within an attribute are defined separately for each market segment (i.d. at 13).

The Companies assert that these attributes were chosen because they were judged to reflect accurately the Department's policies and the national experience with DSM bidding (Exh. C-DSM-5, at 5). The Companies found that the national experience with DSM RFPs revealed that the main resource selection criteria used to score proposals are fairly consistent from one RFP to the next (Exh. C-DSM-4, at 14).

To determine the appropriate relative weights for each attribute, the Companies first examined the Department's I RM rules, D.P.U. 89-239, and other I RM and DSM-related Orders regarding the Department's policies on DSM (Exh. C-DSM-5, at 6). Next, the Companies reviewed attributes and weights used in other DSM RFPs issued in the United

States, how these weights related to the RFPs' objectives, and how these weights may have influenced the results of the RFPs (i d.).

### 3. Independent Evaluator

The Companies proposed to use an independent evaluator ("evaluator") to oversee the proposal evaluation process and to advise the Companies regarding the ranking of proposals for attributes for which it is not feasible to use an a priori set of quantitative scoring criteria (Exh. C-DSM-7, at 42). The Companies consider the use of an evaluator important to ensure that all potential bidders view the resource-selection process as fair (Exh. C-DSM-1, at 12).

The Companies stated that the evaluator would be selected through a competitive solicitation, and would be responsible for directly conducting an initial bid evaluation process according to the evaluator's workplan as proposed in response to the solicitation (Exh. DPU-DSM-31).<sup>34</sup> The Companies proposed that, based on the evaluator's recommendations and any optimization of the initial bid ranking (which would be conducted directly by the Companies), the Companies would file their proposed negotiations group with the Department (Exh. DPU-DSM-31; Exh. C-DSM-1, at 12). The Companies indicated that they would state the reasons for any instance where the Companies' proposed negotiations group differs from that recommended by the evaluator (Exh. C-DSM-1, at 12). The Companies stated that the evaluator would provide a report, summarizing the evaluator's

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<sup>34</sup> The Companies expect that this workplan would be based upon the "general guidelines" developed by the Companies and approved by the Department in this proceeding (Exh. DPU-DSM-25). The Companies have not yet issued an RFP to select the evaluator (i d.).

ranking recommendations as well as the evaluator's comments on those portions of the evaluation conducted directly by the Companies. The evaluator's report would be attached to the Companies' proposed negotiation group filing with the Department (Exh. DPU-DSM-31; Exh. C-DSM-1, at 12). The Companies noted that the evaluator would not be involved with the negotiation phase of the project selection process (Tr. 2, at 38).

C. Positions of the Parties

1. MASSPIRG

MASSPIRG contends that, with the help of outside consultants, "the Companies have proposed a reasonable approach to the difficult problems involved in DSM ... RFPs" (MASSPIRG Reply Brief at 1). Noting that the proposed RFP is the first of its kind in the Commonwealth, MASSPIRG recommends that the Department not order significant revisions to the RFP's project selection process (i.d.).

2. The Companies

The Companies assert that the schedule for the solicitation process was developed based upon the I RM regulations and the Department's May 29, 1992 Procedural Order (Companies Brief at 31). The Companies argue that the schedule, including the method by which bids will be evaluated and selected, is reasonable, appropriate, and consistent with Department regulations and precedent, and thus should be accepted by the Department (i.d. at 48).

D. Standard of Review

The Department's I RM regulations require that an RFP contain all information necessary for project developers to understand and compete fairly in the company's

solicitation process. 220 C.M.R. § 10.03(10)(a). In particular, an RFP must explain the ranking system and any other component of the company's process for selecting project proposals for the award group, as well as the negotiation and contracting procedure. 220 C.M.R. § 10.03(10)(c).

The Department's IRM regulations establish a framework for resource solicitations that was designed to facilitate Department review of a company's proposed resource plan while providing for maximum flexibility in the company's resource selection process. D.P.U. 89-239, at 32-33. In Phase I of the IRM proceeding, the Department reviews a company's RFP to ensure that the RFP's project selection process complies with the resource solicitation framework set forth in 220 C.M.R. §§ 10.00 et seq. An RFP must include a project ranking system that applies relative weights to major categories of resource selection criteria in order to identify the relative importance of these categories in selecting resources.<sup>35</sup> 220 C.M.R. § 10.03(10)(d). The ranking system must specify qualitatively how the criteria are applied to proposals and may be, but need not be, self-scoring. Id. A company is required to submit sufficient documentation of the assumptions, models, and other information to justify the project selection criteria and shall identify any reasons that may cause the company to deviate from the project ranking system in determining the proposed award group. Id.

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<sup>35</sup> The regulations identify certain specific categories of selection criteria that shall be part of the ranking system, including price, quality of output or savings, timing of output or savings, and project feasibility.

### E. Analysis and Findings

The Department finds that, as filed, the Companies' proposal for the RFP ranking system and project selection process is consistent with the resource solicitation process set out in the Department's IMM regulations. The Department finds that the Companies' project evaluation procedure contains the major components established in the IMM regulations for Phase II development of the award group -- namely, screening, ranking, optimization, and negotiation. Further, the Companies have included for bidders a considerable description of this procedure in the RFP.

With respect to the relative weights assigned to the program attributes, the Department finds that (1) the Companies have clearly explained their decision-making process that led to the selection of attribute weights; (2) the Companies have demonstrated that the process used to arrive at the proposed weights considered all relevant factors and utilized the services of recognized expertise in the field; and (3) the resultant weights are consistent with Department DSM objectives. Accordingly, the Department accepts the proposed relative weights of program attributes for the purpose of this DSM solicitation.

The Department approves the use of an independent evaluator to oversee the proposal evaluation process.<sup>36</sup> The Department notes, however, that the use of an independent evaluator in no way diminishes the Companies' obligation to demonstrate the reasonableness of its resource-selection decisions in Phase III as specified in the IMM regulations at 220 C.M.R. § 10.05(2). Further, based on the above analysis, the Department accepts the

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<sup>36</sup> Indeed, the Department commends the Companies for attempting to reassure bidders, through the use of an independent evaluator, that the solicitation will be fair.

Companies' proposal for the RFP ranking system and project selection process, and directs the Companies to determine an award group consistent with Department directives in Section III of this Order.

However, the Companies proposed to file with the Department their "proposed negotiations group" for review in Phase III of this RM proceeding. The purpose of the Department's Phase III review is to review and approve an electric company's final award group -- not a preliminary award group that may be further altered through ongoing substantive negotiations. Therefore, the Department directs the Companies to file their proposed final award group on April 11, 1994, pursuant to the May 29, 1992 Order (see note 4, above), in addition to all other filing requirements set out in 220 C.M.R. § 10.05.<sup>37</sup> Accordingly, the Companies are directed to revise Section 4.0 of the RFP consistent with this schedule of activities.

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<sup>37</sup> The Department will review the Companies' proposed award group in Phase III of these proceedings, to ensure that the DSM resources contained in the award group will result in reliable, least-cost electrical service to the Companies' ratepayers. The Companies are permitted to sign contracts for only those projects approved by the Department for the final award group. See 220 C.M.R. § 10.06.



## VI. INITIAL RESOURCE PORTFOLIO

### A. The Companies' Proposal

The Companies stated that, in compliance with the requirements set forth in 220 CMR § 10.03(5), they have submitted their DSM Initial Resource Portfolio. The DSM Initial Resource Portfolio includes six programs that have been designed to serve residential customers and four programs that have been designed to serve commercial and industrial ("C&I") customers. The programs designed to serve residential customers include (1) the Appliance Efficiency Program, (2) the General Use Program, (3) the Multi-family/Public Housing Program, (4) the Electric Space Heat Program, (5) the Lighting Catalog Program, and (6) the New Construction Program (Exh. C-DSM-9, at 1-2). Programs designed to serve C&I customers are (1) the Equipment Replacement Program, (2) the Small C&I Direct Investment Program; (3) the New Construction Program, and (4) the Independent Savings Supplier Program (i.d.). The Companies stated that the proposed programs are cost-effective and are designed to address all major market sectors and to minimize lost opportunities (i.d.).

The Companies state that they specified the following three goals for the Initial Resource Portfolio: (1) the Initial Resource Portfolio should seek to serve all market sectors, especially hard-to-reach sectors; (2) all programs contained in the Initial Resource Portfolio should be cost-effective; and (3) the Initial Resource Portfolio should be based on experience of their consultants and other utilities, both in New England and nationwide, and on the work of the DSM Task Force<sup>38</sup> (Companies Brief at 51). The Companies assert that, in

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<sup>38</sup> The DSM Task Force was established pursuant to a Settlement Agreement approved by the Department in the Companies' second DSM preapproval proceeding,

developing the program designs contained in the Initial Resource Portfolio, they incorporated information contained in (1) their filing in D.P.U. 92-218, (2) the Report of the Independent Expert, and (3) the process evaluations of the Companies' earlier DSM programs (i.d.). In addition, the Companies assert that they utilized information from leading industry sources regarding DSM program designs (i.d.).

The Companies maintain that their Initial Resource Portfolio contains highly detailed information regarding each of the program designs, including information regarding delivery methods and evaluation plans. They assert, that, consistent with the ILM regulations, they have not included price and cost information in order to ensure the competitiveness of the ILM process (i.d. at 52).<sup>39</sup> The Companies add that the Initial Resource Portfolio is available to all prospective bidders, who can incorporate the program designs in their own programs, if they wish to (i.d. at 61).

#### B. Standard of Review

The ILM regulations address electric companies' requirements with respect to their Initial Resource Portfolios. 220 C.M.R. § 10.03(5). Pursuant to the regulations, companies are required to include, in their Initial Resource Portfolios, cost-effective DSM programs that

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D.P.U. 91-80 Phase-Two-A (1992). The Settlement Agreement also called for the retention of an Independent Expert to chair the Task Force and to assist the Companies in their DSM activities. For a description of the Settlement Agreement, the Task Force, and the Independent Expert, see D.P.U. 91-80 Phase-Two-A at 9-14.

<sup>39</sup> The Companies note that they have provided estimated savings data for each of their proposed programs. They state that the finalized program savings data, which they will submit at the end of Phase II of the current ILM process, may differ from the estimates, as a result of their negotiations with product and service vendors (Companies Brief at 52-53).

target all customer sectors and subsectors and that minimize lost opportunities. 220 CMR § 10.03(5)(a)(5).

In determining the level of information required regarding a company's Initial Resource Portfolio, the Department sought to strike a balance between "the need to prevent self-dealing [by the host company] and the desire to ensure that utility-sponsored projects are not put at a [competitive] disadvantage." D.P.U. 86-36-G at 37 (1989). The Department found that the requirement that a company submit all information required of RFP respondents except for price, method of cost-recovery, and cost information "satisfactorily balanced the competitive interests of utilities and other providers .... [A]ll parties would know in advance the resource the utility would develop in the absence of third parties ... and the company would have to settle on a final price proposal ... at precisely the same time that other project developers would be required." Id. at 39.

### C. Analysis and Findings

In D.P.U. 86-36-G, the Department stated that it is not our "intent to review the electric company's ... [Initial Resource Portfolio] in Phase I unless ... [it] is deficient on its face .... [We] would, however, review in Phases III and IV any portion of the electric company's ... [Initial Resource Portfolio] that ultimately was included in the final" award group. Id. at 37-38.

The Department finds that the programs included in the Companies' DSM Initial Resource Portfolio satisfy the requirements set forth in 220 CMR § 10.03(5); i.e., the programs are cost-effective, they target all customer sectors, and they are designed to minimize lost opportunities. In addition, the Companies submitted, for each of the proposed

programs included in the Initial Resource Portfolio, all of the forms and attachments that will be required of bidders in their RFP responses and indicated on the forms what information they considered to be price- and cost-related and, therefore, not required to be submitted at the present time (See RR-DPU-DSM-20).

The Department finds that the Companies have satisfied the requirements regarding their Initial Resource Portfolio, and accepts the Initial Resource Portfolio as submitted.

## VI I . OTHER ISSUES

### A. Securi ty Provi si ons

#### 1. The Compani es' Proposal

As a threshold, the Compani es proposed to requi re three di fferent types of securi ty from bi dders: completi on securi ty, performance securi ty, and front-loadi ng securi ty. As i ndi cated i n the RFP, these securi ty provi si ons are desi gned to afford protecti on (1)agai nst maki ng payments for programs where i nstall ati ons are not completed, (2)agai nst the ri sk of poor performance once measures are i nstalled, and (3)agai nst the ri sks associ ated wi th the front-loadi ng of contract payments (Exh. C-DSM-7, at 35).

The completi on securi ty i s cal cul ated i n the fol lowi ng manner: (1) the net present value of the bi dder's payment stream i s cal cul ated usi ng the Compani es' di scount factor;<sup>40</sup> (2) the net present value of the bi dder's payment stream i s then converted i nto a nomi nal value for each year by mul ti plyi ng thi s net present value by a projected i nfl ati on rate; and (3) the amount of completi on securi ty requi red for each year i s the nomi nal for each year mul ti pli ed by the percentage of work remai ni ng. Thus, the completi on securi ty wi ll be at a maxi mum at program start up and wi ll be returned i n total to the bi dder upon sati sfactory completi on of all contracted work (i .d.).

The second type of securi ty, performance securi ty, i s cal cul ated by mul ti plyi ng

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<sup>40</sup> The di scount factor i s equal to the product of the projected i nfl ati on rate and the Compani es' margi nal cost of capi tal.

\$0.005 by the proposed annual indexed KWH savings from each project (i.d.).<sup>41</sup> The performance security remains constant throughout the life of the project (i.d. at 36). The Companies stated that they will retain this security for the entire term of the DSM Energy Savings Agreement, and it will be returned to the contractor upon successful completion of the program (i.d.).

The final type of security required is the front-loading security which is calculated in the following manner: (1) the bidder indicates his required nominal payment stream; (2) this nominal payment stream is converted into a present value amount, using the Companies' discount rate; (3) this present value amount is converted into a real levelized payment stream based upon the number of payment periods and the Companies' marginal cost of capital; (4) the real levelized payment stream is adjusted by multiplying the real values by the inflation rate to determine the nominal payment stream; and (5) the annual amount of front-load security required is equal to the proposed nominal payment stream minus the levelized nominal costs of the entire project (Exh. DPU-DSM-64). The cumulative front load security required would be the present year's balance plus the outstanding balance from previous years multiplied by one plus the Companies' discount rate (i.d.).<sup>42</sup> Thus, the front-load

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<sup>41</sup> The \$0.005 per KWH performance and persistence security requirement was determined by taking the \$15 per kilowatt security requirement set forth in 220 C.M.R. § 10.06(2)(i), and translating it into an annual per KWH amount, assuming average annual operation of 3,000 hours per year (Exh. DPU-DSM-13).

<sup>42</sup> One plus the discount rate represents the principal plus a specified rate of return. This formula reimburses the Companies' customers for the time value of money which may be advanced to bidders and ensures that the cumulative front load security will equal zero by the final year.

security will be at a maximum in the beginning and will decrease over time (Exh. C-DSM-7, at 36).

The Companies stated that they would consider the following instruments as acceptable security: cash, irrevocable letter of credit, an escrow deposit, or some other instrument which may be determined during the negotiation phase. No points will be awarded to bidders on the basis of security arrangements, but preference will be given to those bidders who provide larger security arrangements during the negotiation and optimization phase (id.).

## 2. Standard of Review

The IRM regulations specify the minimum types of security required, (i.e., front-load and in-service security) and allow a company to evaluate projects based on each bidder's willingness to provide in-service security above the minimum required. 220 C.M.R. §§ 10.03 (10)(d)(3), 10.06(2)(h). The IRM regulations also specify that alternative in-service security provisions agreed to by the parties and approved by the Department may be allowed. 220 C.M.R. 10.06(2)(i) 7. These alternative provisions may be tied to specific project development milestones or performance criteria. Id.

## 3. Analysis and Findings

As indicated in the record, each security provision is designed to mitigate a particular kind of risk and the required security levels are a function of the degree of risk which that type of security addresses. While the completion security is a function of the percentage of project implementation remaining, it does not explicitly incorporate any milestone criteria. Under the current proposal, an incentive exists for a bidder to propose an ambitious

implementation milestone schedule and thus achieve a higher score under the marketing plan attribute. See Section IV.D.1, supra. However the Department finds that there is no financial penalty for the bidder other than the time value of the completion security, if a program is not implemented in a manner consistent with the proposed milestone schedule. Any penalty to a bidder would be further minimized if the bidder were allowed to receive interest on the posted security. As proposed under the completion security provisions, ratepayers bear the risk of milestones missed during the implementation of DSM measures. Therefore, the Department directs the Companies to explicitly tie completion security to the milestone schedule. See Section IV.D.3, supra. The Companies should submit their proposal regarding the linking of the completion security and the milestone schedule as part of their compliance filing in this proceeding.

The performance security requirement of \$0.005 per KWH is designed to ensure that the annualized savings contracted for will actually be achieved. Only upon successful completion of the DSM Energy Savings Agreement will this security deposit be returned, thereby ensuring some protection for ratepayers against non-performance by contractors. For this reason, the Department finds that the performance security is appropriate and accepts it as proposed.

While the RFP does not promote front loading, it does recognize that front loading may be necessary for certain market segments, most notably the residential segments. The Department's concern in this matter is the degree to which ratepayers are protected against bidders who, having received a large portion of their payments, fail to implement their programs. The Department finds that the Companies have proposed a methodology which



mitigates this risk while still allowing bidders sufficient funding to implement their programs. The security requirement proposal could result in a greater number of bids, and thus a more competitive solicitation. Accordingly, the Department accepts the Companies' proposal for front loading security.

B. Continuation of Current Programs

1. Companies' Proposal

The Companies currently are implementing two residential DSM programs, the Hot Water/General Use program and the Residential Electric Space Heat program (RR-DPU-DSM-29). The Companies indicated that contracts for delivery of program services for each of these programs are in place through June 30, 1994 (i.d.). The Companies indicated that should the Companies' proposals contained in the Initial Resource Portfolio be selected as award group winners, many of these proposed programs would not begin implementation until five or six months after June 30, 1994 (Exh. C-DSM-9, at 26-27). The Companies stated that in order to ensure continuity of services, they would, upon Department approval, extend the time period for current contracts for program services, thus providing for the continuation of DSM program services during the transition period (RR-DPU-DSM-29). Upon the signing of DSM contracts with third parties, the Companies would have the information necessary to properly ramp down the current contracts with program vendors over a predetermined time period (i.d.). This controlled transition would allow the Companies to maintain service continuity to their customers (i.d.).

## 2. Standard of Review

In Boston Edison Company, D.P.U. 91-233, at 7 (1992), the Department required the Company to maintain continuity of demand-side services to each customer class. In that Order, the Department directed Boston Edison Company to continue its existing DSM programs until beginning implementation of those DSM programs that result from a competitive solicitation during the Company's next IRM cycle. Id. at 7. In D.P.U. 92-218, at 18, the Department directed the Companies to maintain the Residential Electric Space Heat and Residential Hot Water/General Use programs, as long as they remain cost-effective, in order to "minimize disruption in the delivery of DSM programs for the Companies' residential customers."

## 3. Analysis and Findings

The Companies stated that should their programs be selected, implementation would not begin immediately. Should an outside service provider win the bid, it, too, might be unable to begin implementation immediately. Therefore, the Companies have proposed a plan to provide continuity of DSM services to their customers beyond the June 30, 1994 contract termination date of their current programs. Department policy has been to maintain continuity of DSM service provision during periods of transition. Once the Companies determine the award group winners in this solicitation, they will possess the information necessary to determine the extent of any interruption in services. Accordingly, the Department directs the Companies to evaluate the benefit of continuing to implement the current DSM programs until such time that DSM programs resulting from this RFP begin implementation. Should the Companies determine that it would be beneficial to continue

implementation of the existing DSM programs during the transition, the Department directs the Companies to request preapproval for such implementation as part of the Companies' Phase III filing in this IRM proceeding.

C. Payments: Gross versus Net

1. The Companies' Proposal

The Companies proposed to make payments to award winners, including cost recovery for their own programs (if applicable), based on a combination of measured energy savings and verified DSM measure installations (Exh C-DSM-7, at 20-21). See Section IV.C, supra. The program performance attribute specifies that, for applicable rate categories and end-uses, all energy savings calculations will be adjusted for variations in weather (i.d. at 50-52). In addition, the program performance attribute provides additional points to bidders who assume greater risk by documenting energy savings within facilities subject to retrofit or modification (i.d.). The Companies acknowledge, however, that neither the measurement and verification procedures proposed by bidders nor the Companies' verification procedures would take into account specific external factors that may alter the calculation of energy savings or the applicable payment to bidders associated with DSM program implementation (Tr. 2, at 22-24). For example, the Companies acknowledge that the energy savings calculation upon which payment would be based would not "net out" free riders (i.d.). Further, the energy savings calculations would not net out changes in the economy, snapback effects, or free drivers (i.d.).

The Companies stated that it would be inappropriate to base payment to bidders on billing analyses or other impact evaluation mechanisms in order to net out external factors

from the energy savings calculations for the following reasons: (1) bidders would not have access to the information (non-participant or control group data) necessary to complete an impact evaluation; (2) bidders would not have the expertise to conduct such an analysis; (3) bidders would not agree to be paid based on the Companies' conducting such an analysis; (4) impact evaluation methodologies such as a billing analysis are inherently fraught with subjectivity and variability, and therefore, are not precise enough to base payments on; and (5) providing DSM implementers with control group data raises significant privacy issues (Tr. 1, at 110-112; Tr. 2, at 60-62).

In hearings, an additional option of applying pre-determined net-to-gross ratios to bidders' savings estimates for payment purposes was investigated. The Companies stated that DSM providers would simply increase their prices to factor in the pre-established net-to-gross ratios, and thus, there would be no net benefit associated with this mechanism (Tr. 2, at 34). The Companies also stated their belief that there would be an additional cost associated with educating the bidder community on this methodology in order for them to properly bid in the RFP (i.d. at 36).

## 2. Standard of Review

The Department's standards regarding net savings calculations define two objectives: (1) to incorporate within cost-effectiveness analyses and lost base revenue calculations all applicable external factors; and (2) to base payment on actual energy savings.

First, in Massachusetts Electric Company, D.P.U. 89-194/195, at 108-113 (1990), the Department determined that both free-rider and snapback effects should be incorporated into utility cost-effectiveness analyses. In Western Massachusetts Electric Company,

D.P.U. 89-260, at 107-108 (1990), the Department determined that the company's lost base revenue calculation should be net of free-ri der and snapback effects. In D.P.U. 93-15/16, the Department found that the Companies "fai led to i ncorporate the economi c vari able" wi thi n thei r savi ngs esti mates, and thus di rected them to do so. Id. at 18, 19.

Second, i n D.P.U. 86-36-F, the Department found that:

[ a] company seeki ng Department pre-approval for a C&LM program should follow the procedures establi shed by the Department for pre-approval contracti ng for generati on opti ons, and desi gn the program i n such a way that cost recovery i s performance-based and i nvolves the type of balanci ng of ri sks among ratepayers and the company as i s set forth i n D.P.U. 86-36-C.

Id. at 30.

In addi ti on, the Department has sought to ensure that (1) cost recovery and the recei pt of DSM benefi ts should be matched i n ti me to the extent possi ble, (2) cost recovery for DSM should be based on the val ue of servi ce, and (3) conservati on and generati on should compete on a level playi ng fi eld i n a market open to all bi dders, uti li ty and non-uti li ty, i n an effort to assure least cost uti li ty resource portfoli os. See D.P.U. 86-36-F at 23, n.9; Western Massachusetts Electri c Company, D.P.U. 86-280, at 252 (1987); Western Massachusetts Electri c Company, D.P.U. 84-25, at 20 (1984).

However, i n D.P.U. 89-194/195, at 173, the Department found i t would be premature and counterproducti ve to requi re Massachusetts Electri c Company and other compani es to move to an excl usi vely performance-based cost recovery system at that ti me. Fi nally, i n D.P.U. 90-335, at 138, the Department di rected Boston Edi son Company "to take steps necessary to i ncorporate such performance-based aspects i nto i ts cost recovery mechani sm i n i ts I RM fi li ng."

### 3. Analysis and Findings

The purpose of this section is to determine whether the Companies' RFP proposal appropriately incorporated the Department's standards regarding performance-based payments. The Department has long understood that external factors such as free-ri der, snapback, and economic effects cannot be factored into energy- and capacity-savings calculations without some form of impact evaluation, i.e., a mechanism that utilizes control group data. See D.P.U. 89-260, at 128, 129. The Companies, however, stated that bidders do not have the information or expertise to conduct their own billing analysis in order to be paid based on its results. Similarly, the Companies indicated that bidders would not be willing to allow payment to be based on billing analyses, which may be fairly subjective, if they are conducted by the Companies.

The Department notes that the Companies propose to pay program implementers based on verified installations and, to a certain extent, on measured energy savings and variations in weather data. See Section III.C, supra. In addition, the Department notes that although the Companies did not propose to base payment on net savings estimates, they did propose to review programs for cost-effectiveness based on net savings estimates determined by the net-to-gross ratios. See Section IV.B, supra.

The Department finds that, although the Companies' proposal does not meet all of our standards for performance-based payments, the Companies' proposed payment structure appears reasonable and appropriate for purposes of this RFP. Therefore, the Department accepts the proposed payment structure for the current proceeding. However, alternatives may be developed in the future that would allow payment to program implementers to be

based on net savings calculations. Accordingly, the Department directs the Companies to fully investigate payment methodologies based on net savings and to incorporate the results in the RFP to be filed in their next IRM proceeding.

D. Regulatory Context

The purpose of this section is to clarify the Department's role in overseeing the performance of the programs that might result from this RFP.

The Companies indicated that bidders whose proposals are award group winners would be, in essence, regulated by the contracts signed with the Companies, which would reflect both the program performance provisions proposed by a bidder, and any security provisions agreed to by the Companies and bidder (Tr. 1, 123-125, Exh. C-DSM-7, at 35). See also Sections IV.C and VII.A, supra.

The Companies also indicated that, should a project that they propose become an award group winner, they would not be bound by the terms of a formal contract, per se (Tr. 3, at 89-90). Rather, the Companies stated that their program bid would establish a legally enforceable obligation in that "the Companies would have a contract through the Department with [their] ratepayers at large to deliver the programs in accordance with [their] bid conditions" (i.d. at 90). The Companies also indicated that the program performance and security provisions in their bid would establish the basis for calculating the savings estimates and rate of payment in the same way as would the provisions of negotiated contracts with non-utility bidders (i.d. at 90-91).

The Department finds the Companies' proposal to manage DSM implementation by non-utility DSM providers via the program performance and security provisions of the

negotiated contract to be appropriate and consistent with the regulations, and to minimize the Department's role in the oversight of services obtained from the competitive marketplace.

The Department notes that, while the IRM regulations do not explicitly address mechanisms to ensure that host electric companies fulfill the terms of a bid should an electric company project be an award group winner, the Companies are correct in viewing their proposal as establishing the parameters of their legal obligations to ratepayers. Therefore, the Department finds the Companies' proposal to view the savings estimates and cost recovery mechanisms specified in their program bid as a "contract" with their ratepayers to be reasonable and appropriate.

The Department emphasizes that it is the Companies' responsibility to ensure that programs are designed and implemented in a cost-effective manner. See Section III, supra. In instances where one of the Companies' programs is an award group winner, and external circumstances change such that the Companies determine that it would not be in ratepayers' interests to fulfill obligations under the terms of a proposal, the Companies should respond according to their best judgment, and should subsequently notify the Department of any changes in program implementation.



#### VIII. DIRECTIVES FOR COMPLIANCE FILING

This section represents a summary of directives that the Companies are expected to comply with. The Companies are directed to make the following changes to the proposed DSM RFP, and present the final RFP to the Department in the form of a compliance filing:

- 1) The Department directs the Companies to make bidders aware of the possibility that "no offers may be accepted, nor contracts signed as a result of this solicitation" as the proposed RFP originally stated (see Section III.D, supra);
- 2) The Department directs the Companies to delete all references to bandwidth methodology in determining the cost-effectiveness of a proposal (see Section IV.B.4.d, supra);
- 3) The Department directs the Companies to require a linkage between the return of project completion security to bidders and the milestone schedule such that financial penalties will accrue to bidders who are unable to meet their proposed milestone schedule (see Section IV.D.3, supra);
- 4) The Department directs the Companies to revise Section 4.0 of the RFP such that the Companies will file the proposed final award group (not a "preliminary negotiations group") with the Department on April 1, 1994 (see Section V.E, supra).

I X. ORDER

Accordingly, after due notice, hearing, and consideration, it is

ORDERED: That the petition of Cambridge Electric Light Company and Commonwealth Electric Company filed with the Department on July 1, 1993 for approval of a request for proposals is approved in part and rejected in part; and it is

FURTHER ORDERED: That Cambridge Electric Light Company and Commonwealth Electric Company shall comply with all directives contained herein; and it is

FURTHER ORDERED: That Cambridge Electric Light Company and Commonwealth Electric Company shall file a request for proposals consistent with the provisions of this Order, and may not issue a request for proposals within Massachusetts until it has been fully approved by the Department.

By Order of the Department,

X. TABLESA. Table 1: Proposed CC Levels and Available Budgets

Commonwealth Rate Category	1994 CC Levels	1994 Budget Available	1995 Budget Available	1996 Budget Available
Residential Non-Heat	\$0.0025	\$2,293,549	\$2,602,722	\$2,722,940
Residential Heat	\$0.0045	\$618,512	\$1,137,875	\$1,394,214
Small C&I	\$0.0045	\$1,542,326	\$1,599,221	\$2,901,958
Medium/Large C&I	\$0.0045	\$1,048,599	\$1,189,256	\$1,679,689
Total Revenue Projected		\$11,915,281	\$12,514,681	\$13,048,270
Less Commitments & LBR		\$5,674,467	\$5,288,358	\$3,445,400
Less Administrative Costs		\$737,828	\$697,249	\$904,069
Total Available Funds		\$5,502,986	\$6,529,074	\$8,698,801
<b>Cambri dge</b> Rate Category	1994 CC Levels	1994 Budget Available	1995 Budget Available	1996 Budget Available
Residential Non-Heat	\$0.0025	\$312,266	\$343,576	\$336,784
Residential Heat	\$0.0045	\$29,219	\$43,833	\$43,917
Small C&I	\$0.0045	\$782,154	\$830,824	\$841,360
Medium/Large C&I	\$0.0045	\$2,386,294	\$3,167,973	\$3,343,985
Total Revenue Projected		\$5,608,643	\$5,860,322	\$6,108,659
Less Commitments & LBR		\$1,472,592	\$779,960	\$809,256
Less Administrative Costs		\$626,118	\$694,156	\$733,306
Total Available Funds		\$3,509,933	\$4,386,206	\$4,566,046
Total System Revenue Projected		\$17,523,924	\$18,375,003	\$19,156,929
Total System Available Funds		\$9,012,919	\$10,915,280	\$13,264,847

B. Table 2: Scoring Criteria and Relative Weights

Attribute	Maximum Points	Scoring Approach
Cost Effectiveness	35	35 points for highest benefit/cost ("B/C") ratio; 0 points for lowest
Program Performance	20	2 points: Equipment Standards 13 points: M&V Protocols 5 points: Payment Schedule
Marketing Plan	15	10 points: Marketing Plan Quality 5 points: Inclusion of Hard-to-Reach Groups
Comprehensiveness	10	8 points: Quality of Comprehensiveness Plan 2 points: Programs focussed on Lost Opportunities
Proposer Qualification and Financial Strength	10	5 points: Proposer Qualifications 5 points: Financial Strength
Customer Contribution	10	10 points for maximum customer contribution; 0 points for minimum